Supreme Court, U.S.

001119 JAN 11 2001

OFFICE OF THE CLERK

No. _____

In The

Supreme Court of the United States

CRYSEN/MONTENAY ENERGY COMPANY,

Petitioner,

v.

SHELL OIL COMPANY and
SCALLOP PETROLEUM COMPANY,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

PETITION FOR A WRIT OF CERTIORARI

JOSEPH D. BECKER,
Counsel of Record
BECKER, GLYNN, MELAMED & MUFFLY LLP
299 Park Avenue
New York, New York 10171
(212) 888-3033

RICHARD N. CHASSIN
ZEB LANDSMAN
KEVIN OLSON,
Of Counsel

Counsel for Petitioner

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

91pp

QUESTIONS PRESENTED

1. Whether a bankruptcy court, which is neither a "court of the United States" nor a "district court" as defined in 28 U.S.C. § 451, may stay proceedings and order arbitration of a dispute under the Federal Arbitration Act, without the participation of a United States District Court, when the Act authorizes only courts of the United States and district courts to make such orders. 9 U.S.C. §§ 3, 4.

2. Whether a bankruptcy court, which may not exercise "judicial power of the United States" (U.S. Const. art. III) except as authorized by 28 U.S.C. § 157(b) and (c), may, in a "non-core" proceeding (*id.* § 157(c)), purport to dismiss the proceeding on the basis of an unreasoned arbitral award without conducting an evidentiary hearing and without proposing genuine findings of fact and conclusions of law to a United States District Court, as required by § 157(c).

PARTIES TO THE PROCEEDING

The caption of the case contains the names of all parties.

Pursuant to Rule 29.6, we advise the Court that the petitioner does not have parent corporations.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
PARTIES TO THE PROCEEDING	ii
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	1
JURISDICTION	1
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE WRIT	5
I. A BANKRUPTCY COURT IS INCOMPETENT TO ORDER ARBITRATION UNDER THE FAA	6
II. UNDER ARTICLE III, A BANKRUPTCY COURT, IN A NON-CORE CASE, CANNOT CONFIRM AN UNREASONED AWARD WITHOUT AN EVIDENTIARY HEARING AND WITHOUT PROPOSING GENUINE FINDINGS OF FACT AND CONCLUSIONS OF LAW TO A DISTRICT COURT, IN COMPLIANCE WITH 28 U.S.C. § 157(c)	11
CONCLUSION	15

TABLE OF AUTHORITIES

Page

CASES

Busic v. United States,
446 U.S. 395 (1980) 10

Cortez Byrd Chips, Inc. v. Bill Harbert Constr. Co.,
120 S.Ct. 1331 (2000) 8

Gouveia v. Tazbin,
37 F.3d 295 (7th Cir. 1994) 10

Griffith v. Oles (In re Hipp),
895 F.2d 1503 (5th Cir. 1990) 8

Jones v. Bank of Santa Fe (In re Courtesy Inns, Ltd., Inc.),
40 F.3d 1084 (10th Cir. 1994) 8

Lexecon v. Milberg Weiss Bershad Hynes & Lerach,
523 U.S. 26 (1998) 8

Matter of Wood,
825 F.2d 90 (5th Cir. 1987) 11

NLRB v. Detroit Newspapers,
185 F.3d 602 (6th Cir. 1999) 10

Northern Pipeline Constr. Co. v. Marathon Pipeline Co.,
458 U.S. 50 (1982) 4, 7, 9, 10, 11

Norwest Bank Worthington v. Ahlers,
485 U.S. 197 (1988) 10

Perroton v. Gray (In re Perroton),
958 F.2d 889 (9th Cir. 1992) 7, 8

United States Nat'l Bank v. Independent Ins. Agents of Am., Inc.,
508 U.S. 439 (1993) 7

TABLE OF AUTHORITIES – Continued

Page

CONSTITUTION, STATUTES AND RULES

U.S. Const. Art. III 2, 4, 5, 6, 7, 11

9 U.S.C. § 3 ..... *passim*

§ 4 ..... 2, 5, 6, 7, 8, 12

§ 7 8

§ 9 ..... 8, 12, 13

§ 10 ..... 8, 12, 13

§ 11 8

§ 16(b) 3

11 U.S.C. § 105(a) 10

28 U.S.C. § 151 4

§ 157 ..... *passim*

§ 158 4

§ 451 ..... 2, 5, 6, 7

§ 1254(1) 1

§ 1334 ..... 2, 4

Sup. Ct. R. 10(c) 5

14(1)(f) 2

OTHER AUTHORITIES

9 C.A. Wright & A.R. Miller, *Federal Practice and Procedure* § 2529 (1995) 13

2 *Collier on Bankruptcy* ¶ 105.01[2] (L.P. King, ed., 15th ed. 2000) 10

3 *Moore's Manual: Federal Practice and Procedure* § 23.06[2](c) (2000) 12

ON PETITION FOR A WRIT OF CERTIORARI

Crysen/Montenay Energy Company ("Crysen") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The Opinion of the Court of Appeals is reported at 226 F.3d 160. Pet. App. A1. The Order of the Court of Appeals denying Crysen's petition for panel rehearing and for rehearing in banc is unreported. Pet. App. A66.

The Opinion of the United States District Court for the Southern District of New York is reported at 240 B.R. 166. Pet. App. A19. The Judgment of that Court is unreported. Pet. App. A49.

The Proposed Findings of Fact and Conclusions of Law of the United States Bankruptcy Court, Southern District of New York, are unreported. Pet. App. A51.

JURISDICTION

The Opinion and the Judgment of the Court of Appeals were entered August 29, 2000. Crysen's timely petition for rehearing, with suggestion for rehearing in banc, was denied by Order entered November 1, 2000. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Pertinent provisions of Article III of the Constitution, of 9 U.S.C. §§ 3 and 4, and of 28 U.S.C. §§ 157 and 451 are reproduced in the appendix to this petition. Sup. Ct. R. 14(1)(f). Pet App. A68-A69.

STATEMENT OF THE CASE

In January 1986, respondent Scallop agreed to buy from Crysen 300,000 barrels of fuel oil.[1] The contract included an arbitration clause. Scallop refused to take delivery of the specified quantity as agreed. Later, in June 1986, Crysen filed for reorganization under Chapter 11 of the Bankruptcy Code.

In March 1987, Crysen, invoking the jurisdiction of the bankruptcy court under 28 U.S.C. §§ 1334 and 157 and Bankruptcy Rule 7001, commenced an adversary proceeding against Scallop in that court on a state law claim of breach of the fuel oil contract, a proceeding duly held by that court to be "non-core." 28 U.S.C. § 157(c). Scallop's application under Federal Arbitration Act § 3 (9 U.S.C. § 3) to stay the proceeding in favor of arbitration was initially refused by the bankruptcy judge in 1987. In 1995, the bankruptcy judge reversed himself, stayed proceedings, and ordered Crysen to arbitrate, ostensibly exercising authority as one of the "courts of the United States"

[1] References to "Scallop" are to respondent Scallop Oil Company and include its parent and successor, respondent Shell Oil Company.

under § 3 of the FAA. Pet. App. A61. The order directing arbitration did not require the arbitral tribunal to keep a record, make or propose findings of fact or state or propose conclusions of law. *Idem*. The order was unappealable. 9 U.S.C. § 16(b).

In 1997, the arbitrators issued an unreasoned, conclusory award denying Crysen's claims; findings of fact and conclusions of law were neither proposed nor made and an opinion was not issued. Pet. App. A63. Upon Scallop's submission of the award, together with part of the evidence submitted to the arbitrators, to the bankruptcy judge for confirmation, the bankruptcy judge issued so-called "Proposed Findings of Fact and Conclusions of Law" in seeming compliance with 28 U.S.C. § 157(c)(1). Pet. App. A51.

The bankruptcy court's proposed findings noted that the record of the proceeding was presented "to the arbitrators" (not to the bankruptcy court), recited the procedural history of the proceeding, spoke of the federal policy favoring arbitration, held that the bankruptcy court may stay litigation and compel arbitration, considered whether Scallop had waived its rights to arbitration, and considered whether the bankruptcy court should vacate the award for manifest disregard of the law. Pet. App. A52-A60. Utterly absent from these so-called proposed findings is any specification of evidence, or to findings based on evidence, as § 157(c) contemplates when it states that the bankruptcy court "may hear a proceeding" and propose findings in light of the hearing. Nevertheless, the bankruptcy court dismissed the proceeding with prejudice. Pet. App. A59.

On Crysen's appeals to the district court under 28 U.S.C. § 158(a), and to the Second Circuit under 28 U.S.C. § 158(d), the decision of the bankruptcy judge was affirmed by both courts on grounds that, we contend, are untenable. Pet. App. A19, A1. In the district court, Judge Cedarbaum, while noting that it was uncertain whether bankruptcy courts were "courts of the United States," held that the power derived by bankruptcy courts from district courts under 28 U.S.C. §§ 1334, 157, and 151 was sufficient to empower the bankruptcy judge to order arbitration. Pet. App. A25-A27. With respect to the Article III constitutional question, she held that recognition of the power of bankruptcy courts to issue certain interlocutory orders, and the *de novo* review of bankruptcy court orders provided by 28 U.S.C. § 158(a), ensured that the teaching of *Northern Pipeline* was not offended.[2] Pet. App. A28-A29.

The Second Circuit took a different line: it affirmed on the irrelevant or mistaken grounds that a bankruptcy court has a "greater" interest in core than in non-core proceedings, that the federal policy favoring arbitration must prevail, that it would be an "absurd" diseconomy to force a party seeking a stay to go to a district court for such an order, and that Crysen's Article III contention was "without foundation," for the bankruptcy judge had complied sufficiently with Section 157(c). Pet. App. A15-A17 n. 7.

---

[2] *Northern Pipeline Constr. Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982) (as non-Article III court, bankruptcy court does not have power to adjudicate state-created rights).

REASONS FOR GRANTING THE WRIT

The petition should be granted because it presents important issues of federal statutory and constitutional law that have not been resolved intelligibly by the Second Circuit or any other federal court. Sup. Ct. R. 10(c). Bankruptcy courts have stayed proceedings and ordered arbitration in core and non-core proceedings[3] without considering that a bankruptcy court is neither a "court of the United States" nor a "district court" as defined by 28 U.S.C. § 451; the FAA does not authorize any other courts to stay proceedings or order arbitration. 9 U.S.C. §§ 3, 4.

Further, when a bankruptcy court is faced with a motion to compel arbitration in a non-core proceeding, § 157(c) speaks incoherently. In enacting § 157(c), Congress apparently considered only the classic non-core case: an adversary proceeding is commenced in the bankruptcy court, a hearing is held in due course, and, to satisfy Article III, the court is limited to *proposing* findings of fact and conclusions of law to the district court based on evidence adduced at the hearing; the district court decides the issues on *de novo* review. But when an application to compel arbitration is filed in the bankruptcy court, the commands of § 157(c) are Delphic. The constitutional concerns that animated enactment of § 157(c) must require that the bankruptcy court anticipate its eventual responsibility as a tentative fact-finder and adjudicator: if the bankruptcy judge orders arbitration (assuming, arguendo, FAA power to do so), the arbitrators must be directed to compile a record and spell out

---

[3] Judge Cedarbaum collected such cases. Pet. App. A29.

findings and legal conclusions in a form that will enable the bankruptcy court and the district court to comply with § 157(c).

Here, the bankruptcy judge simply ordered arbitration, the arbitral tribunal rendered an inscrutable award, and the bankruptcy judge proposed factitious findings and conclusions. Pet. App. A51. Such a charade complies neither with § 157(c) nor Article III. The petition should be granted to fill the gap in an important federal statute designed to cure constitutional difficulty and to reconcile § 157(c) with FAA §§ 3 and 4.

I.

A BANKRUPTCY COURT IS INCOMPETENT TO ORDER ARBITRATION UNDER THE FAA.

FAA § 3 (9 U.S.C. § 3) contemplates that any motion to stay proceedings in favor of arbitration will be made in one of the "courts of the United States," and FAA § 4 contemplates that a motion to order arbitration will be made in a "United States district court." In either case, it is the specified court that is empowered to make the order. The specified courts are defined in 28 U.S.C. § 451.

A bankruptcy court is not a "court of the United States." In defining "court of the United States," the plain language of § 451 speaks specifically and limitatively of judges "entitled to hold office during good behavior." The "good behavior" clause mirrors the text of Article III of the Constitution: "that Congress used Article III language in § 451 supports the view that legislators intended a 'court of the United States' to be an Article III court whose judges have life terms and may only be removed

by impeachment. Bankruptcy judges are Article I not Article III judges." *Perroton v. Gray (In re Perroton)*, 958 F.2d 889, 893 (9th Cir. 1992) (bankruptcy court lacks authority to waive filing fees). Moreover, the overhaul of the bankruptcy statutes undertaken in 1984 (prompted by the Court's decision in *Northern Pipeline*) included a provision *deleting* mention of bankruptcy courts from § 451, which had been provided in the disapproved Bankruptcy Reform Act of 1978. *Id.* at 894.[4]

Nor is a bankruptcy court a "district court." The term "district court" is defined by § 451 as a court "constituted by chapter 5 of this title." Bankruptcy courts are constituted by chapter 6 of Title 28, not chapter 5. They are consequently not district courts in the sense of FAA § 4. Further, the reference in § 4 to the Federal Rules of Civil Procedure and granting the absolute right to jury trial (which bankruptcy courts may not conduct absent consent of all parties, 28 U.S.C. § 157(e)) reinforce the conclusion that bankruptcy courts are incompetent to order arbitration.

The construction of any federal statute is a "holistic endeavor" and must account for the statute's "full text." *United States Nat'l Bank v. Independent Ins. Agents of Am., Inc.*, 508 U.S. 439, 455 (1993). It is a "central tenet of

---

[4] That courts have inherent authority to stay their own proceedings is a rule that cannot apply to a stay granted on motion under FAA § 3 – especially to a stay coupled with an order to arbitrate – without rendering §§ 3 and 4 superfluous. *See United States v. Alaska*, 521 U.S. 1, 59 (1997) (statutory section must not be made "superfluous" or "altogether redundant"). The district court missed the point. Pet. App. A28 n. 4.

interpretation, that a statute is to be considered in all its parts when construing any one of them." *Lexecon v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35-36 (1998). FAA § 7, on compelling attendance of witnesses; § 9, on the confirmation of the arbitral award; § 10, on vacatur of awards; and § 11, on modification of awards, empower the United States district court "for the district" as the only tribunal competent to act. A bankruptcy court is not a court "for" any district. There is not any reason to suppose that Congress had a different court in mind in these sections than in §§ 3 and 4. *See Cortez Byrd Chips, Inc. v. Bill Harbert Constr. Co.*, 120 S.Ct. 1331, 1338 (2000) (interpreting venue provisions of FAA §§ 9-11 by reference to later sections of FAA).

In the result, "[m]ost of the bankruptcy court opinions that have dealt with the issue have concluded that they are not 'courts of the United States' within the meaning of this [§ 451] and related sections." *Jones v. Bank of Santa Fe (In re Courtesy Inns, Ltd., Inc.)*, 40 F.3d 1084, 1086 (10th Cir. 1994) (collecting cases). Accordingly, bankruptcy courts lack competence to waive the payment of filing fees under the Internal Revenue Code; award fees under the Equal Access to Justice Act; impose sanctions under 28 U.S.C. § 1927; and punish for criminal contempt under 18 U.S.C. § 401(3).[5] The power to stay proceedings

---

[5] *Perroton*, 958 F.2d at 893-94 (filing fees); *In re Brickell Investment Corp.*, 922 F.2d 696, 701 (11th Cir. 1991) (attorneys' fees); *In re Davis*, 899 F.2d 1136, 1139-40 (11th Cir.) (Equal Access fees), *cert. denied*, 498 U.S. 981 (1990); *Courtesy Inns*, 40 F.3d at 1086 (sanctions); *Griffith v. Oles (In re Hipp)*, 895 F.2d 1503, 1509-1511 (5th Cir. 1990) (criminal contempt).

and order arbitration under the FAA entails a more fundamental alteration of the course of proceedings than do these incidental powers denied to bankruptcy courts.

These contentions were advanced in the Second Circuit, which addressed none of them. The court of appeals spoke, first, of the difference between core and non-core proceedings and held that a bankruptcy court's power to order arbitration is greater in non-core cases. Pet. App. A15. That discussion is both misconceived – in non-core proceedings a bankruptcy judge has *less* power than in core proceedings[6] – and irrelevant to the issue of statutory construction whether bankruptcy courts are "courts of the United States" or "district courts." Equally amiss is the circuit's emphasis on the strong federal policy favoring arbitration (Pet. App. A15); that policy comes into play *after* it is determined that a court is competent to act.

Nor is the circuit's "strong interest in maximizing scarce judicial resources" to the point. Pet. App. A16. It is not "absurd" to "force a party seeking a stay to go to the district court" (Pet. App. A16) when the FAA, an unambiguous *statute* specifically directed to the issue, empowers only district courts to order arbitration, and when § 157(c) contemplates just that to ensure the constitutionality of bankruptcy court proceedings.

It is of no moment that bankruptcy judges, collectively, constitute "a unit" of the district court under § 151, a fact mentioned suggestively by the court of appeals. Pet. App. A16. Under that section, bankruptcy judges are

---

[6] *Northern Pipeline*, 458 U.S. at 84 (Congress' power to regulate state-created rights are "at a minimum").

authorized to act only under chapter 6, not chapter 5, of Title 28. It would subvert the purpose of chapter 6 as a solvent for the *Northern Pipeline* problem to find a source of power in the term "unit." For the same reason, the fact that the instant proceeding was referred by the district court to a bankruptcy judge under 157(a) does not imply that the *powers* of the district court were also conveyed to the bankruptcy court. Section 157(a) permits the referral of "proceedings," not "powers." *See NLRB v. Detroit Newspapers*, 185 F.3d 602, 605-606 (6th Cir. 1999) (Article III judge cannot delegate to administrative law judge power to decide whether subpoenaed documents are privileged).

The district court thought that bankruptcy courts may order arbitration because the bankruptcy statutes grant to bankruptcy courts, generally, power to issue orders "necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). Pet. App. A27. That was error. It is fundamental that "a more specific statute [here, the FAA] will be given precedence over a more general one, regardless of their temporal sequence." *Busic v. United States*, 446 U.S. 395, 406 (1980). Moreover, the authority given bankruptcy courts by § 105 to carry out "this title" surely "must be exercised within the confines of the bankruptcy code." *Gouveia v. Tazbin*, 37 F.3d 295, 300 (7th Cir. 1994), *citing Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988). "Section 105 does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code or mandates of other state and federal statutes." 2 *Collier on Bankruptcy* ¶ 105.01[2], at 105-7 (L.P. King, ed., 15th ed. 2000).

The unauthorized, unappealable order of the bankruptcy court sealed the fate of the case.

II.

UNDER ARTICLE III, A BANKRUPTCY COURT, IN A NON-CORE CASE, CANNOT CONFIRM AN UNREASONED AWARD WITHOUT AN EVIDENTIARY HEARING AND WITHOUT PROPOSING GENUINE FINDINGS OF FACT AND CONCLUSIONS OF LAW TO A DISTRICT COURT, IN COMPLIANCE WITH 28 U.S.C. § 157(c).

The bankruptcy judge was not an Article III judge, appointed for life, at irreducible pay. U.S. Const. art. III, § 1; 28 U.S.C. § 152(e). He could not, therefore, exercise the "judicial power of the United States," U.S. Const. art III, § 1, except in accordance with procedures established by 28 U.S.C. § 157, enacted in 1984 to conform to constitutional requirements of *Northern Pipeline*. *See Matter of Wood*, 825 F.2d 90, 97 (5th Cir. 1987) (§ 157 enacted to conform to *Northern Pipeline*). In a "non-core" proceeding, *e.g.*, an adversary proceeding by a Chapter 11 debtor based on state created rights, section 157(c) permits a bankruptcy judge, after hearing, merely to propose findings of fact and conclusions of law to a district judge, who alone may enter any final order or judgment after *de novo* review. *Idem.*

In the instant non-core proceeding, the bankruptcy judge purported to exercise judicial power of the United States and ordered arbitration of a dispute under a sales contract governed by state law without any directions to the arbitrators anticipating his responsibilities under § 157(c). After the arbitral tribunal issued an unreasoned

award denying Crysen's claims without findings of fact or conclusions of law, the bankruptcy judge, without an evidentiary hearing, issued a document entitled "Proposed Findings of Fact and Conclusions of Law" that contained neither.

Assume (arguendo) that the bankruptcy judge had power under FAA §§ 3 or 4 to order Crysen to arbitrate. When asked to confirm an inscrutable arbitral award, he was in error to conduct the confirmation proceeding like a district court under FAA §§ 9 and 10 (confirmation of the award absent grave procedural error); he was rather obliged to comply with § 157(c) and, after an evidentiary hearing, refer the proceeding to the district court with *genuine* proposals of findings and conclusions. That is, the bankruptcy judge was bound to comply with usual requirements for findings (or proposed findings):

> . . . the findings must be sufficient to indicate the factual basis for the ultimate decision. Thus, the trial court should include *enough of the underlying or subsidiary facts* to allow a reviewing court to follow the steps that were taken by the trial court to arrive at its conclusion on each factual issue.

3 *Moore's Manual: Federal Practice and Procedure* § 23.06[2](c) (2000) (emphasis supplied). The instant proposed findings of the bankruptcy judge make no reference to the underlying or subsidiary facts presented to the arbitrators. Pet. App. A51-A60.

If – as we contend – such findings are necessary then it must follow that in ordering arbitration the bankruptcy judge must establish rules for the arbitral proceeding that will enable the judge later to comply with § 157(c) and its

constitutional underpinnings, *viz.*, require a record and findings of fact and legal conclusions of the arbitrators, on the basis of which the bankruptcy judge may make necessary and sufficient proposals to the district court; "mere lip service compliance with the rule is not enough." 9 C.A. Wright & A.R. Miller, *Federal Practice and Procedure* § 2529, at 548 (1995) (referring to findings by district judges under Fed. R. Civ. P. 52). The issue thus presented is an important question of federal law grounded in the Constitution that this Court should resolve.

The court of appeals dismissed Crysen's Article III contentions, believing that the district court "complied with § 157(c) and reviewed *de novo* the recommendations of the Bankruptcy Court. . . . " Pet. App. A17 n. 7. That is hardly tenable. In the absence of genuine proposed findings of fact rooted in evidence presented to the bankruptcy court, as required by § 157(c), the district court's review could not possibly have been *de novo*. It was a limited review of the kind contemplated by FAA §§ 9 and 10, not § 157(c), as if the *district* court had ordered arbitration in the first instance.

For example, in disposing of a critical factual issue the district court abdicated its responsibility to review the evidence *de novo* and simply bowed to the circumstance that "the *arbitrators* were presented with evidence" unfavorable to Crysen (emphasis supplied). Pet. App. A44. Again, a serious question of contract interpretation was resolved by the district court's decision that "Crysen has not shown that the arbitrators' interpretation of this clause was erroneous." Pet. App. A45. Finally, another issue was said by the district court to depend on "factual

and credibility determinations that were within the arbitrators' discretion." Pet. App. A45-A46. In none of this, of course, is there reference to the bankruptcy court's findings and conclusions (there were none) nor independent, *de novo* review of the issues required by § 157(c).

The writ should be granted to clarify an important question of federal law and establish that, in a non-core case, a bankruptcy judge, when disposed to grant an application to stay proceedings and order arbitration under the FAA, must refer the application to the supervising United States District Court. Alternatively, assuming (arguendo) the competence of a bankruptcy court to order arbitration under the FAA, the bankruptcy court must direct the arbitral tribunal to keep an official record and make findings of fact and state conclusions of law so that the bankruptcy judge, after hearing, may comply with 28 U.S.C. § 157(c)(1) and propose actual findings of fact and conclusions of law to the supervising district court for *de novo* review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JOSEPH D. BECKER
Counsel of Record
BECKER, GLYNN, MELAMED & MUFFLY LLP
299 Park Avenue
New York, New York 10171
(212) 888-3033

RICHARD N. CHASSIN
ZEB LANDSMAN
KEVIN OLSON,
Of Counsel

Counsel for Petitioner

January 9, 2001.

United States Court of Appeals,
For The Second Circuit

August Term, 1999
(Argued: April 13, 2000 Decided: August 29, 2000)
Docket No. 99-5067

In Re: CRYSEN/MONTENAY ENERGY CO.,

Debtor.

CRYSEN/MONTENAY ENERGY CO.,

Debtor-Appellant,

-v.-

SHELL OIL CO. and SCALLOP PETROLEUM CO.,

Defendants-Appellees.

Before:

NEWMAN, KEARSE, and CABRANES,

Circuit Judges.

Appeal from a judgment of the United States District Court for the Southern District of New York (Miriam Goldman Cedarbaum, *Judge*) accepting the Proposed Findings of Fact and Conclusions of Law of the Bankruptcy Court (Cornelius Blackshear, *Bankruptcy Judge*) and dismissing, following arbitration, claims brought by a Chapter 11 debtor in a noncore adversary proceeding. We affirm the judgment, concluding that: (1) defendants'

failure to replead in subsequent answers an affirmative defense of arbitrability that already had been rejected by the Bankruptcy Court did not constitute an express waiver of the defense; (2) the failure to pursue an interlocutory appeal from the denial in 1987 of a motion to stay in favor of arbitration did not prevent defendants from renewing the motion in 1995; (3) the Bankruptcy Court had the authority to stay the non-core proceeding in favor of arbitration; and (4) the District Court's review of the Bankruptcy Court's recommended disposition was legally sufficient.

Affirmed.

RICHARD N. CHASSIN (Joseph D. Becker and Zeb Landsman *on the brief*), Becker, Glynn, Melamed & Muffly LLP, New York, NY, *for Debtor-Appellant.*

MARK L. WEYMAN, (James L. Michalak, *on the brief*), Anderson Kill & Olick, P.C., New York, NY, *for Defendants-Appellees.*

JOSE A. CABRANES, *Circuit Judge*:

Debtor-appellant Crysen/Montenay Energy Co. ("Crysen") appeals from a judgment of the United States District Court for the Southern District of New York

(Miriam Goldman Cedarbaum, *Judge*) accepting the Proposed Findings of Fact and Conclusions of Law of the Bankruptcy Court (Cornelius Blackshear, *Bankruptcy Judge*) and dismissing, following arbitration, claims brought in a non-core adversary proceeding. We affirm the judgment, concluding that: (1) defendants' failure to replead in subsequent answers an affirmative defense of arbitrability that already had been rejected by the Bankruptcy Court did not constitute an express waiver of the defense; (2) the failure to pursue an interlocutory appeal from the denial in 1987 of a motion to stay in favor of arbitration did not prevent defendants from renewing the motion in 1995; (3) the Bankruptcy Court had the authority to stay the non-core proceeding in favor of arbitration; and (4) the District Court's review of the Bankruptcy Court's recommended disposition was legally sufficient.

BACKGROUND

This action arises out of two contracts pursuant to which Crysen sold oil to defendant Scallop Petroleum Co. ("Scallop"), formerly a subsidiary of defendant Shell Oil Co. ("Shell"). In January 1986, Scallop rejected Crysen's delivery of over 200,000 barrels of oil because the sulfur content of the oil allegedly exceeded the limit specified by the relevant contract. Scallop then refused to allow Crysen to cure the alleged defect, relying on a "time is of the essence" provision to cancel the contract. As oil prices had fallen in the period between agreement and delivery, Scallop purchased less expensive replacement oil and Crysen was forced to re-sell the rejected oil at a lower price.

Crysen, which in June 1986 had filed a petition for relief under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.*, commenced an adversary proceeding against Scallop on March 16, 1987. In its initial answer, Scallop relied on a contractual arbitration clause in asserting a "First Affirmative Defense of Arbitration." Scallop moved shortly thereafter to stay the adversary proceeding in order to submit Crysen's claims to arbitration, but the Bankruptcy Court denied the motion to stay on May 29, 1987.

Scallop filed three amended answers over the next fifteen months. After Crysen subsequently filed an amended complaint naming Shell as a co-defendant, defendants filed an answer on January 6, 1989, requesting a jury trial. Collectively, the four amended answers included thirteen defenses not pleaded in Scallop's original answer; in none of the four answers did Scallop or Shell reassert the arbitrability defense offered in Scallop's original answer.

In 1990, Crysen moved and defendants cross-moved for summary judgment. The Bankruptcy Court denied the motions on the ground that there existed a genuine factual dispute as to whether the oil had conformed to specifications. Following the decision, the parties engaged in extensive discovery, which was not completed until September 1, 1995. Crysen then filed a renewed motion for summary judgment, after which defendants moved by order to show cause why the adversary proceeding should not be stayed in favor of arbitration. The Bankruptcy Court signed the order, entertained argument, and on November 20, 1995, granted the motion to stay. In revisiting and reversing its 1987 decision, the

Bankruptcy Court relied exclusively on *Hays and Co. v. Merrill Lynch, Inc.*, 885 F.2d 1149 (3d Cir.1989), in which the Third Circuit had reversed its own earlier decision and concluded that district courts lack discretion to deny enforcement of an arbitration clause in a non-core adversary proceeding.

The parties then shifted to arbitration. After the arbitration panel issued an Award on January 27, 1997, denying Crysen's claims in their entirety, the matter was returned to the Bankruptcy Court. Finding no reason to vacate the arbitration award, the Bankruptcy Court issued Proposed Findings of Fact and Conclusions of Law recommending that the adversary proceeding be dismissed with prejudice. The District Court accepted the proposed disposition and dismissed the action. *See In Re: Crysen/Montenay Energy Co.*, 240 B.R. 166 (S.D.N.Y.1999). This appeal followed.

DISCUSSION

On appeal, Crysen principally asserts three arguments: that defendants waived their contractual right to arbitrate, that the Bankruptcy Court lacked the authority to stay the non-core proceeding in favor of arbitration, and that the District Court's review of the Bankruptcy Court's recommended disposition was legally insufficient. We address each of these arguments in turn.

I. Waiver

A. *Express Waiver*

Crysen asserts that defendants expressly waived the affirmative defense of arbitrability by failing to include it

in any of the four amended answers that were filed after the Bankruptcy Court had rejected Scallop's May 1987 motion to stay in favor of arbitration. It is well settled that an amended pleading ordinarily supersedes the original and renders it of no legal effect. *See, e.g., Harris v. City of New York*, 186 F.3d 243, 249 (2d Cir.1999). However, we have not yet addressed whether there is a futility exception to this rule where a party fails to advance in a subsequent pleading a claim or defense that already has been rejected by the court. Somewhat surprisingly, there exists a Circuit split on this issue; the Ninth Circuit requires repleading despite obvious futility, *see Marx v. Loral Corp.*, 87 F.3d 1049, 1055-56 (9th Cir.1996) (enforcing the Circuit rule but acknowledging that it has been criticized as unduly formalistic, rigid, and mechanical), while the Tenth and Eleventh Circuits do not, *see Dunn v. Air Line Pilots Ass'n*, 193 F.3d 1185, 1191 n.5 (11th Cir. 1999), *cert. denied*, 120 S.Ct. 2197 (2000); *Davis v. TXO Production Corp.*, 929 F.2d 1515, 1517 (10th Cir. 1991). We see no reason to require repleading of a claim or defense that explicitly has been denied. Accordingly, we hold that defendants' failure to include an arbitration defense in the amended answers filed after the Bankruptcy Court had denied the initial motion to stay did not constitute an express waiver of the defense.

B. *Implied Waiver*

Nor did defendants impliedly waive their ability to move to enforce the contractual arbitration rights. We have explained:

Federal policy strongly favors arbitration as an alternative means of dispute resolution. This preference for arbitration [has] led to its corollary that *any doubts* concerning whether there has been a waiver are resolved in favor of arbitration. We have often stated that waiver of arbitration is not to be lightly inferred.

Nonetheless, a party waives its right to arbitration when it engages in protracted litigation that prejudices the opposing party. [P]rejudice as defined by our cases refers to the inherent unfairness – in terms of delay, expense, or damage to a party's legal position – that occurs when the party's opponent forces it to litigate an issue and later seeks to arbitrate that same issue. Incurring legal expenses inherent in the litigation, without more, is insufficient evidence of prejudice to justify a finding of waiver. Thus, we have found that a party waived its right to arbitration where it engaged in extensive pretrial discovery and forced its adversary to respond to substantive motions, delayed invoking arbitration rights by filing multiple appeals and substantive motions while an adversary incurred unnecessary delay and expense, and engaged in discovery procedures not available in arbitration.

Therefore, in determining whether [a party] has waived its right to arbitration, we will consider such factors as (1) the time elapsed from commencement of litigation to the request for arbitration, (2) the amount of litigation (including any substantive motions and discovery), and (3) proof of prejudice. There is no bright-line rule, however, for determining when a party has

> waived its right to arbitration: the determination of waiver depends on *the particular facts of each case.*

PPG Industries, Inc. v. Webster Auto Parts Inc., 128 F.3d 103, 107-08 (2d Cir. 1997) (emphases added) (internal citations and quotation marks omitted) (alteration in original) (concluding that a party that engaged in discovery and filed a substantive motion prior to filing a petition to compel arbitration had waived its contractual right to arbitrate).

The "particular facts" of the instant case do not lend themselves to ready application of the standard set forth above. In looking to the first prong under *PPG*, it is clear that "the time elapsed from commencement of litigation to the request for arbitration" was minimal. However, as Crysen emphasizes, Scallop did not seek an interlocutory appeal of the denial of its timely motion for a stay. With regard to the second prong, "the amount of litigation (including any substantive motions and discovery)" was substantial: The parties litigated for eight years – six of which followed the Third Circuit's decision in *Hays* – including extensive discovery and cross-motions for summary judgment. The third *PPG* prong – proof of prejudice – largely collapses into the second; Crysen arguably was prejudiced because it had to litigate the action for eight years. *Cf. id.* at 107; *Cotton v. Slone*, 4 F.3d 176, 179-80 (2d Cir.1993) (finding prejudice where the party seeking to enforce an arbitration clause already had availed itself of pre-trial discovery, brought substantive motions, and invoked the powers and procedures of the district court).

Had defendants first moved in 1995 for a stay in favor of arbitration – eight years after the suit had been

filed – there could be no doubt of waiver under *PPG*. However, the instant case is far different than *PPG* because of the motion to stay filed by Scallop shortly after the action was brought in 1987. Accordingly, the issue facing us here simply was not presented in *PPG*: Are defendants responsible for the eight years of litigation because of Scallop's failure to take an interlocutory appeal from the denial of the motion to stay in favor of arbitration? In light of Scallop's prompt filing in 1987 of the motion to stay, the strong federal preference in favor of arbitration, and the policy against finding an implied waiver of arbitration rights when there exist "any doubts" on that score, we decline to disturb the District Court's holding that defendants did not impliedly waive their arbitrability defense.

Our conclusion – that the failure to take an interlocutory appeal of the denial of the motion to stay did not constitute an implied waiver of defendants' arbitrability defense, despite the intervening years of litigation that took place before the motion was renewed – does not conflict with *Cotton* because that decision relied on a statutory provision that had not been enacted in 1987, when Scallop failed to appeal. In *Cotton*, we held that a defendant had waived his contractual right to compel arbitration where: (1) the District Court denied the defendant's motion to compel arbitration; (2) he failed to take an interlocutory appeal as of right under § 16(a) of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 16(a)(1);[1] and

---

[1] Section 16(a), which was enacted on November 19, 1988, *see* Pub.L. No. 100-702, tit. X, § 1019, 102 Stat. 4671, § 15, provides that "[a]n appeal may be taken from – (1) an order –

(3) he proceeded with discovery and made several substantive motions before finally challenging on appeal from a final (default) judgment the denial of the motion to compel. *See Cotton*, 4 F.3d at 179-80. We concluded that "[t]he aims of section 16(a) would be defeated if a party could reserve its right to appeal an interlocutory order denying arbitration, allow the substantive lawsuit to run its course (which could take years), and then, if dissatisfied with the result, seek to enforce the right to arbitration on appeal from the final judgment." *Id.* at 180. Accordingly, we held that the defendant had waived his right to compel arbitration.

Although Crysen contends that *Cotton* requires us to conclude that defendants in the instant case waived their arbitrability defense, we believe the issue is controlled not by *Cotton* but by our earlier decision in *Drayer v. Krasner*, 572 F.2d 348 (2d Cir.1978) (Friendly, J.). The *Cotton* decision makes no reference to *Drayer*, in which we concluded that a party that had failed to take an available interlocutory appeal of an order granting a stay in favor of arbitration *did not* waive his right to challenge the

---

(A) refusing a stay of any action under section 3 of this title. . . ." 9 U.S.C. § 16(a)(1). Section 3, in turn, provides:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending . . . shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement. . . .

9 U.S.C. § 3.

arbitration clause on appeal from a final judgment. In *Drayer*, the defendants moved for, and the District Court granted, a stay to enforce an arbitration clause in the relevant contract. The plaintiff – Drayer – failed to file an interlocutory appeal from the stay order, though he could have done so. *See Drayer*, 572 F.2d at 350. Instead, Drayer waited, lost on the merits in arbitration, and then on appeal attacked the District Court's confirmation of the arbitration award, claiming that the contractual arbitration clause was illegal. We held that Drayer had not waived his ability to challenge the District Court's decision to stay in favor of arbitration, stating that "[f]ailure to take an authorized appeal from an interlocutory order *does not preclude raising the question on appeal from the final judgment.*" *Id.* at 353 (emphasis added).

We agree with the District Court, *see* 240 B.R. at 175, that the holdings in these two cases are irreconcilable; the *Cotton* decision *sub silentio* overruled *Drayer*.[2] We apply

---

[2] We recognize that the procedural postures of the two cases were somewhat different: In *Drayer*, the plaintiff failed to take an immediate appeal from the District Court's decision *granting* a motion to stay the action pending arbitration, and instead challenged the order staying the action on appeal from the District Court's entry of a final judgment confirming an adverse arbitration award. *See Drayer*, 572 F.2d at 350, 352-53. By contrast, the defendant in *Cotton* attacked on appeal from a final judgment the District Court's *denial* of his motion to stay the action pending arbitration. *See Cotton*, 4 F.3d at 178. Neither side has suggested how this distinction might be a material one, and we conclude that the distinction has no bearing on the issue before us: whether Scallop impliedly waived its right to arbitrate by failing to take an interlocutory appeal from the Bankruptcy Court's initial *denial* of Scallop's motion to stay in

Drayer, not *Cotton*, to the instant case because our decision in *Cotton* focused on the "aims of section 16(a)," 4 F.3d at 180, a provision we described as having been "designed to streamline the appellate aspect of the litigation process so that parties may realize their arbitration rights at the earliest possible moment." *Id.* Section 16(a) is not relevant to the instant case because Scallop's failure to take an interlocutory appeal occurred in May 1987, approximately eighteen months prior to the enactment of the statutory provision at issue in *Cotton*. Scallop had no right to an interlocutory appeal under § 16(a); Scallop's right to an immediate appeal instead was analogous to Drayer's,[3] and, as noted, Drayer's "[f]ailure to take an authorized appeal from an interlocutory order d[id] not preclude raising the question on appeal from the final

---

favor of arbitration and then by litigating the action for eight years before renewing the motion to stay.

[3] Defendants argue that Scallop had *no* right in 1987 to an interlocutory appeal of the Bankruptcy Court's decision denying the motion to stay pending arbitration. We conclude that Scallop, like Drayer, could have taken an interlocutory appeal under *Enelow v. New York Life Ins. Co.*, 293 U.S. 379 (1935), and *Ettelson v. Metropolitan Life Ins. Co.*, 317 U.S. 188 (1942) (together, "Enelow-Ettelson"). Though the *Enelow-Ettelson* doctrine was much-criticized, and eventually was overturned by the Supreme Court in *Gulfstream Aerospace Corp. v. Mayacamas Corp.*, 485 U.S. 271 (1988) (itself largely mooted by the enactment of § 16(a) a few months later), the doctrine was as available to Scallop in 1987 as it had been to Drayer over a decade earlier.

judgment."[4] *Drayer*, 572 F.2d at 353. As defendants had not impliedly waived the right to contest on appeal from a final judgment the failure of the Bankruptcy Court to grant the stay, nothing prevented them from asking the Bankruptcy Court to reconsider its earlier decision in advance of the entry of judgment. As the District Court stated, "[f]or Crysen, Congress acted one-and-a-half years too late." 240 B.R. at 176.

In sum, we conclude that despite the failure to appeal immediately the Bankruptcy Court's denial of the 1987 motion to stay in favor of arbitration, under *Drayer* defendants cannot be held responsible for the eight years of litigation that followed, nor for any resultant prejudice to Crysen. Accordingly, we conclude that under the standard set forth in *PPG*, defendants did not waive their arbitrability defense.[5]

---

[4] Because *Drayer* was the governing law of this Circuit in 1987, it may well have influenced Scallop's decision not to take an interlocutory appeal of the denial of its motion to stay in favor of arbitration.

[5] We also reject Crysen's contention that the Bankruptcy Court improperly ignored the law of the case in granting the 1995 motion to stay. Relying on the intervening *Hays* decision, the Bankruptcy Court concluded in 1995 that it improperly had found in 1987 that it had discretion to deny a stay in favor of arbitration. The law of the case doctrine in no way prevents such reconsideration. As we have explained, the doctrine "posits that if a court decides a rule of law, that decision should continue to govern in subsequent stages of the same case. . . . Application of the law of the case doctrine is discretionary and does not limit a court's power to reconsider its own decisions prior to final judgment." *Sagendorf-Teal v. County of Rensselaer*, 100 F.3d 270, 277 (2d Cir. 1996) (internal quotation marks omitted); *see also United States v. Williams*, 205 F.3d 23, 34 (2d Cir.

II. The Bankruptcy Court's Power to Stay

Our recent decision in *In re United States Lines, Inc.*, 197 F.3d 631, 640-41 (2d Cir. 1999), *cert. denied*, 120 S.Ct. 1532, (2000), makes it clear that bankruptcy courts have the power to stay non-core proceedings in favor of arbitration. In explaining our holding that bankruptcy courts in some circumstances retain discretion to decline to stay core proceedings in favor of arbitration, we noted in U.S. *Lines* that any conflict between the Bankruptcy Code, which favors centralization of disputes concerning a debtor's estate, and the Arbitration Act, which advocates a decentralized approach to dispute resolution,

> is lessened in non-core proceedings which are unlikely to present a conflict sufficient to override by implication the presumption in favor of arbitration. *See Hays & Co.*, 885 F.2d at 1161. Core proceedings implicate more pressing bankruptcy concerns, but even a determination that a proceeding is core will not automatically give the bankruptcy court discretion to stay arbitration.

Id. at 640. This statement is pregnant with the assumption, which we now state explicitly, that bankruptcy courts *have* authority to stay *non-core* proceedings in favor of arbitration.

The issue in *U.S. Lines* was whether a bankruptcy court *may decline* to stay a *core* proceeding in favor of

---

2000). In the instant case, the District Court did not enter final judgment between 1987 and 1995, thereby leaving it wholly within the Bankruptcy Court's discretion to reconsider its prior decision.

arbitration. As we noted there, the presumption in favor of arbitration generally will trump the lesser interest of bankruptcy courts in adjudicating non-core proceedings that could otherwise be arbitrated. We also explained that "even" in core proceedings, in which the interest of the bankruptcy court is greater, the bankruptcy court nonetheless *might* lack discretion to decline to stay in favor of arbitration. The unmistakable implication is that bankruptcy courts generally *do not* have discretion to *decline* to stay *non-core* proceedings in favor of arbitration, and they certainly have authority to grant such a stay. If, as we suggested in *U.S. Lines*, bankruptcy courts *must* stay non-core proceedings, logic compels the conclusion that they are empowered to do so, notwithstanding Crysen's claim to the contrary.

The implicit conclusion in *U.S. Lines* that bankruptcy courts generally must stay non-core proceedings in favor of arbitration is in harmony with the general principles governing arbitration and bankruptcy law. We have explained that "bankruptcy jurisdiction [is] to be construed as broadly as possible within . . . constitutional constraints." *In re Ben Cooper, Inc.*, 896 F.2d 1394, 1398 (2d Cir.), *vacated*, 498 U.S. 964, (1990), *reinstated*, 924 F.2d 36 (2d Cir. 1991); *see also In re S.G. Phillips Constructors, Inc.*, 45 F.3d 702, 705 (2d Cir. 1995). In addition, the Supreme Court has instructed that "[t]he Arbitration Act . . . establishes a federal policy favoring arbitration." *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (internal quotation marks omitted). Crysen's position – that bankruptcy courts may not stay non-core proceedings in favor of arbitration – is at odds with both of these principles.

Our strong interest in maximizing scarce judicial resources likewise supports the conclusion that bankruptcy courts may stay non-core proceedings in favor of arbitration. The Third Circuit's *Hays* decision – holding that district courts *must* stay non-core proceedings in favor of arbitration – is generally accepted. *See, e.g., U.S. Lines*, 197 F.3d at 640-41; *In re Nat'l Gypsum Co.*, 118 F.3d 1056, 1066 (5th Cir. 1997) (noting that *Hays* "makes eminent sense" and "has been universally accepted"). It would make no sense to find that bankruptcy courts – which are constituted under 28 U.S.C. § 151 as "unit[s] of the district court" – cannot stay such proceedings; the absurd result of such a decision would be to force a party seeking a stay to go to the district court and have it remove the reference to the bankruptcy court so that the district court could entertain a motion that, under *Hays* and its progeny, it cannot deny. We decline to impose on courts and litigants this wholly unnecessary burden.

III. The District Court's Review Was Legally Sufficient

Finally, the District Court's review of the Bankruptcy Court's recommended disposition, which in turn was based on the Award of the arbitration panel, was entirely adequate as a matter of law. The statute delineating a bankruptcy court's authority in adjudicating a non-core proceeding requires that a district court undertake a *de novo* review of the bankruptcy court's proposed findings of fact and conclusions of law. *See* 28 U.S.C. § 157(c)(1).[6]

---

[6] Section 157(c) provides in relevant part that a "bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11.

In the instant case, the District Court properly explained that it "reviews *de novo* those portions of a bankruptcy judge's proposed findings of fact and conclusions of law to which any party has [objected]." 240 B.R. at 169. Crysen nonetheless claims that the District Court failed to comply with the commands of § 157(c) because the Court did not undertake a *de novo* review of the arbitration award, but rather reviewed it for "manifest disregard of the law." *Id.* at 177. This claim is devoid of merit. Crysen's suggestion – that in a non-core proceeding a district court must review *de novo* an arbitration award, not simply the bankruptcy court's own review of that award – is illogical and without support. The District Court properly reviewed the decision of the Bankruptcy Court by putting itself in the position of the Bankruptcy Court when it offered its recommendation – that is, by reviewing the award for manifest disregard of law. This is precisely what *de novo* review required.[7]

In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected."

[7] Crysen's claim that the District Court's review ran afoul of the constitutional concerns that animated the Supreme Court's plurality opinion in *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, (1982), is equally without foundation. As we have just explained, in handling this matter the Bankruptcy and District Courts followed the prescriptions established by § 157(c). Congress enacted that provision in direct response to *Marathon*. *See generally U.S. Lines*, 197 F.3d at 636-37 (explaining *Marathon*, § 157, and the genesis of the core/

CONCLUSION

To summarize, we hold that:

(1) a defendant's failure to include in an amended pleading a defense that already had been rejected explicitly by the trial court did not constitute an express waiver of the defense;

(2) the failure to take an interlocutory appeal from the Bankruptcy Court's denial in 1987 of a motion to stay in favor of arbitration, prior to the enactment of 9 U.S.C. § 16(a), did not prevent defendants from renewing the motion in 1995;

(3) bankruptcy courts possess the authority to stay non-core proceedings in favor of arbitration; and

(4) the District Court's review of the Bankruptcy Court's recommended disposition was legally sufficient.

Accordingly, we affirm the judgment of the District Court, which accepted the Bankruptcy Court's Proposed Findings of Fact and Conclusions of Law and dismissed Crysen's claims.

---

non-core distinction). Because the District Court complied with § 157(c) and reviewed *de novo* the recommendations of the Bankruptcy Court, this case implicates none of the constitutional concerns identified by the Supreme Court in *Marathon*.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

---X

In Re CRYSEN/MONTENAY ENERGY COMPANY,

Debtor.

---X

CRYSEN/MONTENAY ENERGY COMPANY,

Plaintiff,

97 Civ. 5072 (MGC)

-against-

OPINION

SHELL OIL COMPANY and SCALLOP PETROLEUM COMPANY,

Defendants.

---X

APPEARANCES:

BECKER, GLYNN, MELAMED & MUFFLY LLP
Attorneys for Debtor/Plaintiff
299 Park Avenue
New York, New York 10171

By: Richard N. Chassin, Esq.
Matthew W. Woodruff, Esq.
Zeb Landsman, Esq.

ANDERSON KILL & OLICK, P.C.
Attorneys for Defendants
1251 Avenue of the Americas
New York, New York 10020-1182

By: Mark L. Weyman, Esq.
Noah H. Charlson, Esq.

CEDARBAUM, J.

This is a non-core adversary proceeding arising out of a contract for the sale of fuel oil from Crysen/Montenay Energy Company ("Crysen") to Scallop Petroleum Company. After filing for bankruptcy, Crysen sued Scallop and Shell Oil Company, Scallop's former parent company and successor-in-interest, for breach of contract. Following more than eight years of litigation, Bankruptcy Judge Blackshear referred the proceeding to arbitration. The arbitration panel found for defendants, and Judge Blackshear issued proposed findings of fact and conclusions of law confirming the arbitration award and granting defendants' motion to dismiss the adversary proceeding with prejudice. Crysen now files objections to the proposed findings of fact and conclusions of law pursuant to 28 U.S.C. § 157(c)(1), arguing, *inter alia*, that the bankruptcy judge lacked the power to order arbitration and, in any event, erred in ordering arbitration because defendants had waived any right they had to arbitration. For the reasons set forth below, I accept Judge Blackshear's proposed conclusions of law and dismiss the adversary proceeding with prejudice.

BACKGROUND

In January of 1986, Scallop contracted with Crysen for the purchase of 300,000 barrels of fuel oil with a maximum sulfur content of 0.7 percent, at a price of $24.55 per barrel. (Pl. App.[1] 420.) After a portion of the

---

[1] "Pl. App." refers to the "General Appendix" submitted in support of Crysen's objections.

contracted-for oil was discharged from the transporting vessel to Scallop's appointed port, Scallop asserted that the oil did not conform to the contract and refused to accept the remainder. While contesting Scallop's assertion, Crysen "cured" the allegedly non-conforming oil which had been discharged from the vessel by supplying a cargo of low-sulfur fuel oil for blending. However, Scallop allegedly refused to allow Crysen to "cure" the balance of the cargo, which had not been discharged from the vessel. According to Crysen, it ultimately sold this cargo to another customer at a lower price.

The contract between Crysen and Scallop provided: "All disputes arising or in connection with this contract will be determined by arbitration in New York, New York in accordance with the Rules of the American Arbitration Association by (3) three arbitrators." (Pl App. 420b.)

In June of 1986, Crysen filed a petition for reorganization under chapter 11 of the United States Bankruptcy Code. On March 16, 1987, Crysen commenced an adversary proceeding against Scallop pursuant to 11 U.S.C. § 521 *et seq.*, asserting a claim based on Scallop's rejection of the fuel oil.[2] The complaint alleged that the action was a "core proceeding" under 28 U.S.C. § 157(b)(2). (Pl. App. 18.) Scallop's answer to the complaint, dated May 7, 1987, asserted a "First Affirmative Defense of Arbitration as to

---

[2] Crysen also asserted claims (claims two and three) based on two other contracts that the parties had entered into in January and February of 1986. (Pl. App. 17-24.) Claim three was withdrawn by stipulation in 1990. A portion of claim two was apparently resolved by the arbitrators, but neither party now objects to the disposition of that claim.

All Claims." On May 29, 1987, Bankruptcy Judge Blackshear denied Scallop's motion to stay the proceeding and submit the claims to arbitration. (Pl App. 57-59.) Scallop did not appeal Judge Blackshear's order, and the parties now dispute whether that order was appealable at the time.

Scallop then served amended answers dated December 15, 1987, March 11, 1988, and August 25, 1988, none of which asserted a defense of arbitrability. (Pl. App. 60, 66, 78.) By stipulation dated November 15, 1988, Scallop and Crysen agreed that Shell – Scallop's parent company which had assumed Scallop's rights and liabilities in December 1987 – would be added as a defendant. (Pl. App. 88.) Pursuant to that stipulation, Crysen served an amended complaint dated December 19, 1988 naming Scallop and Shell as defendants. (Pl. App. 93.) Scallop and Shell served an answer to the amended complaint and demanded a trial by jury on Crysen's claims. (Pl. App. 102.) Scallop and Shell did not assert a defense of arbitrability in this pleading.

Crysen moved for partial summary judgment in April 1990, arguing that even if the oil was non-conforming, Scallop wrongfully rejected the undischarged fuel by denying Crysen the right to cure under N.Y.U.C.C. § 2-508(2). (Pl. 1990 App.[3] 1-2, 141.) In May of 1990, defendants "cross-moved" for partial summary judgment, arguing that N.Y.U.C.C. § 2-508(2) is inapplicable because the time-of-the-essence clause in the contract

---

[3] "Pl. 1990 App." refers to the appendix submitted by Crysen relating to the 1990 motions for partial summary judgment.

effectively eliminated Crysen's right to cure after the time set for performance. (*Id.* at 161-63, 555-80.) Defendants also sought a declaration that the fuel oil was non-conforming. (*Id.* at 551-55.) In a decision dated September 24, 1991, Judge Blackshear held that whether the oil conformed was a genuine issue of disputed fact. He also ruled that because the finder of fact might ultimately determine that the oil was conforming, thus mooting the cure issue, it was appropriate not to decide the legal question of whether Crysen had a right to cure. "[A] determination by this Court after trial that the oil does not conform to the contract specifications, would allow either party to again move for summary judgment on the issue of cure." (Pl. App. 128.)

In November of 1993, defendants sought to compel additional discovery. Judge Blackshear denied defendants' application, but permitted defendants to designate two additional expert witnesses for trial. (Pl. App. 199-200.)

On August 12, 1994, upon defendants' motion, Judge Blackshear ruled that the adversary proceeding was non-core. (Pl App. 201-202.)

By notice of motion dated September 27, 1994, the defendants moved in the district court for an order withdrawing the reference from the bankruptcy court. The defendants argued that the claims should be adjudicated in the district court in light of the non-core determination and defendants' demand for a jury trial. Judge Duffy denied the motion, without opinion, on November 14, 1994. Defendants sought reargument, and Judge Duffy denied that application on January 5, 1995.

At the same time, Crysen moved in the bankruptcy court to strike defendants' demand for a jury trial. Defendants filed a "cross-motion" demanding a jury trial. At a December 7, 1994 hearing, Judge Blackshear denied Crysen's motion. (Pl. App. 278, 728.)

In October of 1995, the defendants renewed their 1987 application to stay the adversary proceeding and to compel arbitration of the claims. By order dated November 20, 1995, Judge Blackshear granted defendants' motion. (Pl. App. 394-95.)

A panel of three arbitrators issued an award on January 29, 1997 denying Crysen's claims in their entirety. (Pl. App. 396-97.) In proposed findings of fact and conclusions of law, Judge Blackshear recommended confirmation of the arbitration award.

DISCUSSION

I. Standard of Review

In non-core proceedings, the district court reviews *de novo* those portions of a bankruptcy judge's proposed findings of fact and conclusions of law to which any party has made timely and specific objection. 28 U.S.C. § 157(c)(1); *see also* Fed. R. Bankr. P. 9033(d).

II. Bankruptcy Court's Power to Compel Arbitration

Crysen argues that the bankruptcy judge did not have the power to compel arbitration, because sections 3 and 4 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 1 *et seq.*, authorize only a United States district court to direct the parties to arbitrate, and because the power to

compel arbitration is not one of the designated powers of a bankruptcy judge under chapter 6 of title 28 of the United States Code. Crysen also points to references in the FAA to the Federal Rules of Civil Procedure and jury trials as confirming that bankruptcy judges are not empowered to stay proceedings and compel arbitration. Crysen does not, however, cite any case holding or implying that a bankruptcy judge does not have the power to stay proceedings and compel arbitration. The FAA provides that "courts of the United States" may stay an action pending arbitration:

> "If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration."

9 U.S.C. § 3.

It is debatable whether the term "courts of the United States" as used in the FAA should be interpreted to refer directly to bankruptcy courts. The term "courts of the United States" is not defined in the FAA. Moreover, the pertinent section of the FAA was enacted prior to the reconfiguration of the bankruptcy courts in 1978 and 1984. Act of July 30, 1947, Pub. L. No. 80-282, 61 Stat. 669. In construing the statutory language "courts of the

United States" in other contexts, appellate courts have disagreed as to whether the term includes bankruptcy courts. *Compare Grewe v. United States* (*In re Grewe*), 4 F.3d 299, 304-05 (4th Cir. 1993), and *United States v. Yochum* (*In re Yochum*), 89 F.3d 661, 668-69 (9th Cir. 1996) (holding that a bankruptcy court may award attorneys' fees under 26 U.S.C. § 7430(a)), *with Brickell Inv. Corp. v. Dade Helicopter Jet Service Inc.* (*In re Brickell Inv. Corp.*), 922 F.2d 696, 698-702 (11th Cir. 1991) (holding that "court[s] of the United States," as used in 26 U.S.C. § 7430, refers only to Article III courts).

Even if Crysen is correct that the language of the FAA should not be construed to refer directly to bankruptcy courts, bankruptcy judges have the power to stay proceedings and compel arbitration by virtue of the district courts' referral of jurisdiction. Section 1334 (b) of title 28 of the United States Code provides that the district courts shall have original jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11. The district court may, in turn, refer these proceedings to the bankruptcy judges for the district. 28 U.S.C. § 157(a). Bankruptcy judges are empowered to "hear and determine" all core proceedings arising under title 11, or arising in a case under title 11, and to enter appropriate orders and judgments. 28 U.S.C. § 157(b)(1). A bankruptcy judge is also empowered to "hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11." 28 U.S.C. § 157(c)(1). However, in such a proceeding, the bankruptcy judge must submit proposed findings of fact and conclusions of law to the district court, which has the power the enter final orders or judgments. *Id.*

Bankruptcy judges.do not have an independent source of jurisdiction. Their power is derived from district courts. *See* 28 U.S.C. §§ 1334 (a) and (b); 28 U.S.C. § 157(a); *see also* 1 Lawrence P. King, *Collier on Bankruptcy* ¶ 3.02[1] (15th Ed. Rev. 1999) ("The entire grant of jurisdiction to the district courts made by section 1334 (a) and (b) – title 11 cases, and any or all proceedings arising under title 11 or arising in or related to a case under title 11 – may be referred to the bankruptcy judges."); 1 William L. Norton, Jr., *Norton Bankruptcy Law & Prac. 2d* (1999) § 4:18 (the "1984 Bankruptcy Amendments, in 28 U.S.C.A. § 1334(a), (b), and (e) . . . initially vest all bankruptcy jurisdiction in the District Courts, but contemplate that their jurisdiction will be exercised in major part, if not entirely, by the bankruptcy judges of the district"). Indeed, the Judiciary Act provides that "the bankruptcy judges in regular active service shall constitute a unit of the district court." 28 U.S.C. § 151.

By implication, the statute gives a bankruptcy judge all powers needed to adjudicate a non-core proceeding except the power to enter a final order or judgment. *Compare* 28 U.S.C. 157(b)(1) (specifying a bankruptcy judge's powers in core proceedings) *with* 28 U.S.C. 157 (c)(1) (specifying a bankruptcy judge's powers in non-core proceedings); *see also* 11 U.S.C. § 105(a) ("The [bankruptcy] court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [title 11]."); *Celotex Corp. v. Edwards*, 514 U.S. 300, 310 n.7 (1995) (bankruptcy court "did not lack jurisdiction under § 157(c)(1) to" stay execution of supersedeas bond "because that injunction was not a 'final order or judgment' "); 1 *Norton Bankruptcy Law & Prac. 2d* § 4:18

("When a case is referred under § 157(a), Congress surely intends that all jurisdiction otherwise vested in the District Courts be exercised by the bankruptcy judges, except to the extent that § 157(c)(1) requires the entry of the final order in a proceeding related to a bankruptcy case by the District Court or that § 157(d) contemplates a withdrawal by the District Court.").

In order for Crysen to be correct, a bankruptcy judge's derivative power to "hear" a non-core proceeding would not include the power to enter an interlocutory order staying the action and compelling arbitration in accordance with a contractual agreement to arbitrate. There is no reason to construe a bankruptcy judge's power so narrowly. A district court clearly has such power – by virtue of both its inherent power and statute[4] – and the bankruptcy judge's jurisdiction derives from the district court. Moreover, courts have recognized that in non-core proceedings, a bankruptcy judge has the power to enter other types of interlocutory orders that are not specified by statute. *See, e.g., Elkins v. X-Alpha Int'l, Ltd. (In re Kennedy)*, 48 B.R. 621, 623, 622 (Bankr. D. Ariz. 1985) (holding that bankruptcy court had authority to remand action to state court; "bankruptcy interlocutory orders in non-core proceedings need not be submitted to District Court").

---

[4] A district court's power to order a stay of proceedings pending arbitration is inherent in the court itself. *Gavlik Constr. Co. v. H.F. Campbell Co.*, 526 F.2d 777 (3rd Cir. 1975), *overruled on other grounds, Zosky v. Boyer*, 856 F.2d 554 (3rd Cir. 1988).

Finally, the parties do not seriously dispute that, in this case, the bankruptcy judge's order compelling arbitration is subject to *de novo* review by the district court. As a result, the bankruptcy judge's enforcement of an arbitration clause under these circumstances does not even indirectly run afoul of 28 U.S.C. § 157(c)(1), which prohibits a bankruptcy judge from entering a final order or judgment in a non-core proceeding. For similar reasons, a bankruptcy judge's enforcement of an arbitration clause does not offend the teaching of *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).

These conclusions are consistent with the common assumption as well as the practice in Article III courts and bankruptcy courts. Bankruptcy judges regularly compel arbitration. *See, e.g., James P. Barkman, Inc. v Granger Constr. Co. (In re James P. Barkman, Inc.)*, 170 B.R. 321 (Bankr. E.D. Mich. 1994); *Hupp Indus., Inc. v. Environmental Prod. Amalg. Pty., Inc. (In re Hupp Indus., Inc.)*, 157 B.R. 360 (Bankr. N.D. Ohio 1993); *Midwest Communications Corp. v. Black Entertainment Television (In re Midwest Communications Corp.)*, 144 B.R. 354 (Bankr. E.D. Ky. 1992). District judges in this circuit have impliedly held that bankruptcy judges have the power to compel arbitration. *See Bousa Inc. v. Neste Oy (In re Bousa Inc.)*, No. 92 Civ. 6194, 1993 WL 78019, at *3 (S.D.N.Y. March 16, 1993) ("[s]ince Article III judges are bound to honor agreements to arbitrate, presumably non-core proceedings involving non-executory contracts should place bankruptcy judges under similar restriction") (vacating the bankruptcy judge's denial of a motion to compel arbitration and remanding for further proceedings); *United States Lines, Inc. v. American Steamship Owners Mutual (In re United*

States Lines, Inc.), 220 B.R. 5, 13 (S.D.N.Y.1997) (vacating the bankruptcy judge's denial of a motion to compel arbitration and remanding for further proceedings). In fact, in applying Supreme Court cases requiring rigorous enforcement of agreements to arbitrate, *see, e.g., Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) and *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989), courts have held that bankruptcy judges are *required* to enforce an applicable arbitration provision unless enforcement would conflict with the purpose or provisions of the Bankruptcy Code. *See, e.g., National Gypsum v. NGC Settlement Trust & Asbestos*, 118 F.3d 1056 (5th Cir. 1997).

For the foregoing reasons, the bankruptcy judge had the power to stay the proceeding and compel arbitration in this case.

III. Waiver

Crysen also argues that defendants (1) expressly waived their right to arbitration by abandoning the affirmative defense of arbitrability in all amended pleadings subsequent to the 1987 denial of Scallop's initial application to arbitrate, and (2) impliedly waived their right by actively participating in the litigation despite defendants' right to appeal the 1987 denial of the application to arbitrate.

A. Amended Pleadings

Following the bankruptcy judge's denial of Scallop's motion to stay the proceeding and submit the claims to

arbitration on May 29, 1987, Scallop, and then Scallop and Shell, did not assert a defense of arbitrability in any of the four amended answers.

In support of its argument that this failure to re-plead constitutes an express waiver, Crysen relies on *Gilmore v. Shearson/American Express Inc.*, 811 F. 2d 108 (2d Cir. 1987). That case is not on point. There, the defendant had voluntarily and expressly withdrawn a pending motion to compel arbitration and later tried to renew the motion after the plaintiff amended its complaint. The Court of Appeals held that the defendant's withdrawal of the motion – which the defendant did not dispute was an express waiver of its right to arbitrate the claims in the original complaint – precluded it from reviving its arbitration demand in its response to the amended complaint. *Id.* at 111-12.

In this case, defendants did not withdraw the motion to arbitrate. Rather, they omitted the affirmative defense of arbitrability in their subsequent answers after the bankruptcy judge had denied their motion to arbitrate and ruled that the defense of arbitration was unavailable. Under such circumstances, it would be unreasonable to call the amended pleadings an express waiver of arbitration.

Courts of appeals have differed over the analogous issue of whether a party may appeal the dismissal of a claim in the original pleading in cases in which the amended pleading did not reassert the claim. *Compare Davis v. TXO Prod. Corp.*, 929 F.2d 1515, 1517-18 (10th Cir. 1991) (holding that a party does not waive its right to appeal dismissal of the claim in such circumstances) and

Wilson v. First Houston Inv. Corp., 566 F.2d 1235, 1237-38 (5th Cir. 1978), *vacated on other grounds*, 444 U.S. 959 (1979), (same) *with Marx v. Loral Corp.*, 87 F.3d 1049, 1055-56 (9th Cir. 1996) (holding that a party may not attack the dismissal of a claim in such circumstances; noting also that "other courts, as well as legal scholars, have criticized this Circuit's rule as 'formalistic', 'rigid,' and 'too mechanical.' "); *see also United States v. Bonanno Organized Crime Family*, 695 F. Supp. 1426, 1432 (E.D.N.Y. 1988) ("The logical rule should be that filing an amended complaint omitting claims that the court has dismissed on substantive grounds does not waive the plaintiff's right to appeal the court's dismissal of those claims.") (citing 3 Moore, *Moore's Federal Practice* ¶ *15.08[8]* (2d ed. 1987) and 6 Wright & Miller, *Federal Practice & Procedure* § 1476 (1971)). Crysen suggests no reason to believe that the Second Circuit would follow the aberrational rule of the Ninth Circuit. In fact, in its memorandum of law, Crysen effectively conceded that if the bankruptcy judge had not ultimately stayed the proceeding to permit arbitration, defendants could have appealed the denial of the motion to arbitrate at the end of the proceeding.[5]

Crysen also relies on Second Circuit opinions stating the general rule that "an amended complaint ordinarily supersedes the original and renders it of no legal effect."

---

[5] Crysen states that it "does not contend that defendants were precluded from challenging the 1987 Order on direct appeal to the district court at the end of the case." (Pl. Memo. of Law at 25 n.6.) At oral argument, however, Crysen suggested that defendants in fact would have been precluded from appealing the original order at the end of the case. (7/10/98 Tr. at 4; *but see id.* at 19-20.)

International Controls Corp. v. Vesco, 556 F.2d 665, 668 (2d Cir. 1977). None of the cases cited by Crysen are analogous to this case. For instance, in *Vesco*, the issue was whether a default judgment based on the original complaint was valid where an amended complaint was filed but not properly served on the defendant.

Accordingly, the defendants' failure to continue to plead a defense of arbitrability following the denial of their motion to arbitrate was not an express waiver of their demand to arbitrate.

B. Implied Waiver

Standard for Waiver. Federal policy strongly favors arbitration as an alternative means of dispute resolution. *PPG Indus Inc., Inc. v. Webster Auto Parts Inc.*, 128 F.3d 103, 107 (2d Cir. 1997). "The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983). Similarly, the Second Circuit has "emphasized that . . . waiver of the right to arbitration is not to be lightly inferred," *Cotton v. Slone*, 4 F.3d 176, 179 (2d Cir. 1993) (internal citation omitted), and that the issue of waiver should be evaluated "with a healthy regard for the policy of promoting arbitration," *Doctor's Assocs., Inc. v. Distajo*, 107 F.3d 126, 130 (2d Cir.), *cert. denied*, 118 S. Ct. 365 (1997) (internal citation omitted).

Nonetheless, where a party does not (1) take "appropriate steps to secure" its right to arbitrate and (2) engages in protracted litigation that prejudices the opposing party, it waives its right to arbitrate. *Cotton*, 4 F.3d at 179; *see also* 9 U.S.C. § 3 (on application, a court shall stay the trial of an action subject to arbitration, "providing the applicant for the stay is not in default in proceeding with such arbitration").

Few reported decisions address the first element of waiver, because in most waiver cases, the party ultimately seeking arbitration, unlike Scallop in this case, delayed taking *any* steps to secure its contractual right. Here, Scallop promptly demanded arbitration and moved for a stay pending arbitration.

By contrast, the "prejudice" element of waiver has been construed repeatedly. "[Plrejudice . . . refers to the inherent unfairness – in terms of delay, expense, or damage to a party's legal position – that occurs when the party's opponent forces it to litigate an issue and later seeks to arbitrate that same issue." *PPG Indus., Inc.*, 128 F.3d at 107 (quoting *Doctor's Assocs.*, 107 F.3d at 134). Incurring legal expenses inherent in litigation, without more, is insufficient evidence of prejudice to justify a finding of waiver. *Id.* (citing *Leadertex, Inc. v. Morgantown Dyeing & Finishing Corp.*, 67 F.3d 20, 26 (2d Cir. 1995)). The Second Circuit has found prejudice where the party invoking arbitration engaged in extensive pre-trial discovery and forced its adversary to respond to substantive motions before seeking arbitration, *see Com-Tech Assocs. v. Computer Assocs. Int'l. Inc.*, 938 F.2d 1574, 1576-77 (2d Cir. 1991), filed multiple appeals and substantive motions before seeking arbitration while an adversary incurred

unnecessary delay and expense, *see Kramer v. Hammond*, 943 F.2d 176, 179 (2d Cir. 1991), and engaged in discovery procedures not available in arbitration before seeking arbitration, *see Zwitserse Maatschappij Van Levensverzekering En Lijfrente v ABN Int'l Capital Mkts. Corp.*, 996 F.2d 1478, 1480 (2d Cir. 1993) (*per curiam*).

While these are factors to consider, there is no bright-line rule for determining when a party has waived its right to arbitration. *PPG Indus., Inc.*, 128 F.3d at 107-08.

"Prejudice." There is no question that after the bankruptcy judge denied Scallop's prompt motion to stay the proceeding and compel arbitration, the defendants actively litigated the dispute and engaged in conduct that was inconsistent with arbitration.

In opposing Crysen's motion for summary judgment, defendants filed a partial summary judgment motion in 1990 on the central issue of whether the oil conformed to contractual specifications. *See Sweater Bee by Banff, Ltd. v. Manhattan Indus., Inc.*, 754 F.2d 457, 465 (2d Cir. 1985) (stating that motion for summary judgment on a particular issue would constitute waiver of right to arbitrate that issue) (citing *Weight Watchers of Quebec Ltd. v. Weight Watchers Int'l Inc.*, 398 F. Supp. 1057, 1061 (E.D.N.Y. 1975)). Defendants also (successfully) litigated their right to a jury trial and (unsuccessfully) moved to withdraw the reference, which was relief inconsistent with arbitration. *See generally Leadertex*, 67 F.3d at 25 (defendant's "conduct has been largely inconsistent with its present assertion of its right to compel arbitration"). In addition, defendants engaged in substantial discovery, *see Com-*

Tech, 938 F.2d at 1576-77 (taking of ten pre-trial depositions was factor in finding prejudice), although it is not clear whether they obtained discovery that would have been unavailable in arbitration.

Unlike most waiver cases, however, the party seeking to arbitrate did not delay in seeking arbitration. Accordingly, the prejudice inquiry here is less dispositive. The more difficult issue is whether defendants took appropriate steps to preserve their right to arbitration.

Failure to Take Interlocutory Appeal. A party that fails to take an authorized appeal from an interlocutory order is generally permitted to raise the question on appeal from the final judgment. In *Drayer v. Krasner*, 572 F.2d 348, 353 (2d Cir. 1978), the district court granted defendants' motion for a stay pending arbitration, and plaintiff made no attempt to appeal the stay order. The parties thereafter arbitrated the wrongful termination claim, and the arbitrators issued an award for the defendants. The district court confirmed the award, and the plaintiff appealed, arguing, *inter alia*, that the arbitration clause was invalid. Judge Friendly noted that plaintiff could have appealed the district court's interlocutory order staying the action pending arbitration under 28 U.S.C. § 1292(a)(1) and the doctrine of *Enelow v. New York Life Ins. Co.*, 293 U.S. 379 (1935), and *Ettelson v. Metropolitan Life Ins. Co.*, 317 U.S. 188 (1942). Nevertheless, Judge Friendly concluded that plaintiff could attack the stay order after the arbitration had been completed: "Failure to take an authorized appeal from an interlocutory order does not preclude raising the question on appeal from the final judgment." *Drayer*, 572 F.2d at 353.

The Second Circuit has, *sub silentio*, modified this rule in light of the 1988 amendment to the Federal Arbitration Act. In *Cotton v. Slone*, the Second Circuit held that a party waives its right to arbitrate when it does not file an interlocutory appeal, under FAA § 16, of a denial of its application to arbitrate and thereafter actively litigates the dispute. 4 F.3d 176 (2d Cir. 1993). In *Cotton*, the defendant moved to compel arbitration and to stay the proceeding pending arbitration. The district court denied the motion, and the defendant then moved for certification of an interlocutory appeal under 28 U.S.C. § 1292(b). The district court denied the motion to certify, and the defendant thereafter answered the complaint and pleaded arbitrability as a defense. The defendant proceeded to "participate actively in discovery and motion practice concerning [plaintiff's] claims over the next three years." *Id.* at 178. The Court of Appeals held that the defendant waived his right to arbitrate by actively participating in the litigation without having sought immediate appellate review available under the FAA, with which the defendant was "demonstrably familiar." *Id.* at 179-80. Such review, while not available as of right under 28 U.S.C. § 1292(b), was available as of right under section 16(a) of the FAA.

Section 16(a) of the FAA provides that an interlocutory appeal "may be taken" from an order that denies a motion either to compel arbitration or for a stay pending arbitration, and explicitly disallows an appeal as of right from an interlocutory order that grants a stay. 9 U.S.C. §§ 16(a)(1) and (b). Section 16(a) is designed both "to streamline the appellate aspect of the litigation process so that parties may realize their arbitration rights at the

earliest possible moment," and to further the liberal federal policy favoring arbitration by authorizing interlocutory appeals only from orders denying arbitration. *Cotton*, 4 F.3d. at 180. Applying section 16(a) to the facts of that case, the *Cotton* Court stated that "[t]he aims of section 16(a) would be defeated if a party could reserve its right to appeal an interlocutory order denying arbitration, allow the substantive lawsuit to run its course (which could take years), and then, if dissatisfied with the result, seek to enforce the right to arbitration on appeal from the final judgment." *Id.*

In this case, Scallop could not have utilized section 16(a) to appeal the bankruptcy judge's May 1987 order denying its motion to stay proceedings and compel arbitration. Section 16(a) was enacted 18 months after that order, on November 19, 1988. Judicial Improvements and Access to Justice Act, Pub. L. No. 100-702, § 1019(a), 102 Stat. 4642 (1988) (enacting the text of section 15, which was subsequently renumbered as section 16). *Cf. Hays and Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 885 F.2d 1149 (3d Cir. 1989) (section 16 applied retroactively to an appeal *that was pending* on the date of the enactment of that section); *Delmay v. Paine Webber*, 872 F.2d 356 (11th Cir. 1989) (same).

It is arguable but not clear that defendants may have been able to file an interlocutory appeal pursuant to the *"Enelow-Ettelson"* doctrine – the same doctrine under which the plaintiff in *Drayer* could have appealed. Under that doctrine, an order staying or refusing to stay "proceedings in federal district court pending arbitration [was then deemed] an appealable interlocutory order [granting or] refusing an injunction, 28 U.S.C. § 1292(a)(1), if the

action in which the order was made is an action which, before the fusion of law and equity, was by its nature an action at law." *Gilmore v. Shearson/American Express Inc.*, 811 F.2d 108, 110 (2d Cir. 1987); *Manning v. Energy Conversion Devices, Inc.*, 833 F.2d 1096, 1101 (2d Cir. 1987). The *Enelow-Ettelson* doctrine was good law, albeit much criticized, until the Supreme Court overruled the precedents on which it was based in March of 1988. *See Gulfstream Aerospace Corp., v. Mayacamas Corp.*, 485 U.S. 271 (1988). It would have afforded Scallop a right to appeal if the action were deemed one at law (which seems likely) and if the doctrine were applied to appeals from a bankruptcy court to a district court. It is not clear, however, whether the doctrine would have been so applied. Appeals may be taken from interlocutory orders of a bankruptcy judge only "with leave of the court." 28 U.S.C. § 158(a). While the statute does not provide guidance as to when leave should be given, courts have looked by analogy to the standards set forth in 28 U.S.C. §§ 1292 (a) and (b), which govern appeals of interlocutory decisions from the district courts to the courts of appeals.[6] *See, e.g., Clark v. Sanders (In re Reserve Prod., Inc.)*, 190 B.R. 287, 290 (E.D.

---

[6] 28 U.S.C. § 158(c)(2) provides that "An appeal under subsections (a) and (b) of this section shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts and in the time provided by Rule 8002 of the Bankruptcy Rules." Some courts have interpreted this language to mean that the decision whether to grant leave to appeal should be guided by the standards applicable to interlocutory appeals to the courts of appeals. *See, e.g., North Fork Bank v. Abelson*, 207 B.R. 382, 389 (E.D.N.Y. 1997); *K-Mart Corp. v. Swann Ltd. Partnership (In re Swann Ltd.* Partnership), 128 B.R. 138, 141 (D. Md. 1991).

Tex. 1995); *48th St. Steakhouse, Inc. v. Rockefeller Group, Inc. (In re 48th St. Steakhouse, Inc.)*, 46 B.R. 227, 228-29 (S.D.N.Y. 1985)

If Scallop could not appeal as of right from the initial order denying arbitration, its failure to seek an appeal could not be considered a waiver, even under *Cotton*. If Scallop could have appealed the initial order denying arbitration under the *Enelow-Ettelson* doctrine, this case would not differ materially from *Drayer*: Scallop would have had a right to challenge Judge Blackshear's order on appeal from the final judgment. In that case, Crysen would have suffered even greater prejudice if the defendants had not renewed their motion to arbitrate. The case would have been tried in the bankruptcy court, and on appeal, the district court or the court of appeals could have vacated the judgment and compelled arbitration. *See Clark v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 924 F.2d 550 (4th Cir. 1991) (vacating judgement following a jury verdict because district court erred in denying defendant's motion to compel arbitration; defendant had not waived right to raise issue on appeal, although interlocutory denial of arbitration motion had been appealable).

The ability to appeal the denial of a motion to arbitrate at the end of the case admittedly can delay the realization of arbitration rights and lead to inefficient results. But, as *Cotton* makes clear, eliminating this inefficiency was one of the aims of Congress in enacting section 16(a) of the FAA. For Crysen, Congress acted one-and-a-half years too late.

Crysen does not argue that defendants had an obligation to renew their motion to arbitrate earlier than they

did. I have found no authority for imposing such an obligation on a party seeking arbitration.[7]

Because defendants would have had a right to challenge the bankruptcy judge's denial of their 1987 motion to arbitrate on appeal from the final judgment, they did not waive their right to arbitrate by failing to file an interlocutory appeal under the *Enelow-Ettelson* doctrine.

IV. Review of the Arbitration Award

Crysen argues that the bankruptcy judge erred by refusing to vacate the arbitration award, which Crysen contends was entered in manifest disregard of the law.

---

[7] *Metz v Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 39 F.3d 1482 (10th Cir. 1994), which in any event is not binding in this Circuit, is distinguishable. In that case, Merrill Lynch appealed the initial denial of the motion to compel arbitration pursuant to FAA § 16, but then filed a "motion to dismiss" that interlocutory appeal because a number of circuits had held that Title VII claims were not arbitrable. One year later, a bench trial was held and judgment was entered. Thereafter, Merrill Lynch filed a notice of appeal and a Rule 60(b)(6) motion to vacate the judgment on the ground that the law had become clear that Title VII claims are arbitrable. The Tenth Circuit held that Merrill Lynch's withdrawal of its interlocutory appeal did not "without more" constitute waiver because, at the time of the withdrawal, the arbitrability issue "was an open question" in that circuit and had been ruled on adversely in other circuits. The court noted, however, that the change in law on which Merrill Lynch relied on appeal occurred one month before the trial. Nonetheless, Merrill Lynch "waited until after trial . . . to reassert its right to arbitrate." *Id.* at 1490. The court held that "the totality of Merrill Lynch's conduct constituted waiver of its right to compel arbitration."

Crysen also claims that the arbitrators, by certain evidentiary rulings, effectively refused to hear evidence "pertinent and material to the controversy." 9 U.S.C. § 10 (a).

A. Manifest Disregard of the Law

An arbitration award may be vacated if it is in manifest disregard of the law. *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197, 202 (2d Cir. 1998), *cert. denied*, 119 S. Ct. 1286 (1999). The Second Circuit has cautioned that the reach of this doctrine is "severely limited," and that manifest disregard "clearly means more than error or misunderstanding with respect to the law." *Id.* (citations omitted). To modify or vacate an award on this ground, a court must find both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit and clearly applicable to the case. *Id.* The burden of proving a ground for vacating an arbitration award rests on the party who seeks to vacate it. *Application of National Assoc. of Broadcast Employees & Technicians*, 707 F. Supp. 124, 128 (S.D.N.Y. 1988).

Where arbitrators give no explanation for their decision, the award must be affirmed if a ground for the decision can be inferred from the facts of the case. *Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp.*, 103 F.3d 9, 13 (2d Cir. 1997). This is so even if the ground for their decision is based on an error of fact or an error of law. *Id.* If there is even a barely colorable justification for the outcome reached, the court must confirm the arbitration award. *Id.*

According to Crysen, the arbitration panel disregarded case law holding that where a neutral tester fails to follow the methods set out in a contract, his test results are invalid and not binding on the parties. Crysen argues that the third party charged with testing the quality of the fuel oil, E.W. Saybolt & Co., Inc., did not follow the testing methods set out in the parties' contract. Accordingly, the conclusion that the oil did not conform to the contract should not have been binding on Crysen.

The contract provided, "Inspection: At disport costs to be shared 50/50. -Quality based on vessel composite." (Pl. App. 420a.) The contract further specified that, for the fuel oil's sulfur content, the ASTM Test Method was to be D-1552. (*Id.* 420.) The parties agree that these provisions required that vessel composite sampling occur prior to discharge, and further agree that such a sampling was not taken at the disport. (After discharge was stopped, however, a vessel composite was eventually taken of the portion of the oil that had not yet been discharged.)

Defendants argued to the arbitrators that a full vessel composite sampling could not be taken because the ship's hatch domes were sealed and that ladders blocked the ullage holes on that ship. (Resp. Post-Hearing Memo. of Law 9-10.) Defendants argued that the hatches had been sealed because the ship did not satisfy United States Coast Guard requirements. The contract provided that Crysen "warrants that the ship used to carry the cargo shall satisfy the maritime legal requirements of the United States of America." (Pl. App. 420a.) Defendants argued that because the specified method of inspection was not possible, it was proper to use alternate, reasonable inspection methods. It relied on N.Y.U.C.C.

§ 2-513(4)[8] and testimony of its experts as to the reasonableness of the alternate testing procedures. Defendants also argued that under the contract, the parties had a joint responsibility to inspect the oil, and the fact that some of the oil was discharged prior to inspection did not amount to a waiver by Scallop of its right of inspection.

Crysen relies primarily on *Cities Services Co. v. Derby & Co.*, 654 F. Supp. 492 (S.D.N.Y. 1987). That case held that a plaintiff seller was not bound by test results of an independent third-party inspector, where the sampling techniques were not in accordance with the contract or generally accepted practice, and the errors were of sufficient magnitude to justify an inference of fraud, bad faith or gross error. *Cities Services* is distinguishable from this case. In *Cities Services*, there was no question that the inspector could have performed the tests in accordance with the contract. In this case, the arbitrators were presented with evidence that Saybolt could not have conducted a full vessel composite sampling at the time the ship arrived at Scallop's port. The arbitrators did not

---

[8] N.Y.U.C.C. § 2-513(4) (McKinney 1993) provides: "A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract." N.Y.U.C.C. § 2-513(1) provides that "where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner."

The contract is governed by New York law.

manifestly disregard the law by concluding that this case fell outside the principle enunciated in *Cities Services*.

Crysen also argues that Scallop was not justified in rejecting Crysen's offer to cure after the January 29 contract deadline for delivery. Crysen asserts that it could have delivered enough low-sulphur fuel oil for blending by February 4 which was a reasonable time following the January 29 deadline. Crysen relies on N.Y.U.C.C. § 2-508(2) (McKinney 1993), which provides: "Where the buyer rejects a non-conforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender." Defendants argued to the arbitration panel that the time-of-the-essence clause effectively eliminated Crysen's right to cure after the time set for performance. That clause provided: "With respect to the dates of delivery of the oil hereunder, time is of the essence of this agreement. In the event delivery is not effected within the dates agreed, [Scallop] may cancel this contract or hold [Crysen] responsible for any damages for [Crysen's] failure to deliver the oil timely hereunder." (Pl. App. 420b.) Crysen has not shown that the arbitrators' interpretation of this clause was erroneous. In any event, "simple misinterpretations of contracts" are not a basis to vacate an arbitration award. *I/S Stavborg v. National Metal Converters, Inc.*, 500 F.2d 424, 432 (2d Cir. 1974).

Crysen argued that Scallop acted in a manner inconsistent with the time-of-the-essence clause and effectively waived its rights thereunder. (Pl. 1990 App. 152-53.) This

issue depends upon factual and credibility determinations that were within the arbitrators' discretion. Crysen has made no showing that the arbitrators exercised that discretion in manifest disregard of the law.

Because there was a barely colorable justification for the outcome reached, the arbitration award must be confirmed.

B. Refusal to Hear Evidence

Under section 10(a) of the FAA, an arbitration award may be vacated "[w]here the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy." 9 U.S.C. § 10(a). Arbitrators are afforded broad discretion to determine whether to hear evidence, and a court may vacate an arbitration award only if the complained-of evidentiary ruling deprived the parties of a fundamentally fair hearing. *Areca Inc. v. Oppenheimer & Co.*, 960 F. Supp. 52, 54 (S.D.N.Y. 1997).

Crysen argues that the arbitrators "refus [ed] to hear evidence pertinent and material to the controversy" by restricting the scope of cross-examination of Bruce Abugel, one of defendants' experts. Crysen asserts that its cross-examination of other of defendants' experts was restricted as well, but it does not point to the hearing transcript or otherwise specify what cross-examination was restricted. Crysen has not shown clearly how its cross-examination was limited. Crysen points to only one question that the arbitrators did not permit Crysen to ask, after having ruled that Abugel could not testify about

factual matters outside his personal knowledge but that his expert opinions could stand. Crysen objects to the following:

> Q: [Quoting from Abugel's deposition] "' . . . there is an automatic sampling called a McFarlane drip sampler that does allow automatic sampling taken from the line on a drip basis, and if that is what he was referring to, then that was automatic sampling.' [D]o you know for a fact whether Saybolt or the [receiving port] was using a McFarlane drip sampler?"
>
> A: "No, based on what I've seen, no, I don't. Just a drip sampler. I don't know who manufactured it."
>
> Q: "You go on to say, 'If he was referring. . . . ' "
>
> Arbitrator: "Excuse me. Aren't you doing just what we said we didn't want to hear? He doesn't know what was coming out of this pipe. All he knows – you're asking him what does this testimony mean, and is this really helpful to us?"

(Pl. App. 724.)

Moreover, Crysen cross-examined Abugel extensively and took his deposition prior to the hearing. A party does not have an absolute right to cross-examination at an arbitration hearing. *Sunshine Mining Co. v. United Steelworkers of America*, 823 F.2d 1289, 1295 (9th Cir. 1987).

Crysen objects to the arbitrators' receipt of the experts' affidavits on similar grounds. Defendants made clear, however, that they were not proffering the affidavits as evidence of any facts, but that the affidavits

merely set out the record evidence on which the experts were relying in formulating their opinions. (Resp. Opp. to Claimant's Motion to Strike Affs. 11-12.)

Crysen has failed to show that the limitation on cross-examination and the admission of the affidavits deprived it of a fair hearing.

CONCLUSION

For the reasons set forth above, I accept the proposed findings of fact and conclusions of law of the bankruptcy judge to the extent that I hold that the bankruptcy judge had the power to compel arbitration, defendants did not waive their right to arbitration, and the arbitrators did not enter their award in manifest disregard of the law. The adversary proceeding is dismissed with prejudice.

SO ORDERED.

Dated: New York, New York
August 31, 1999

/s/ Miriam Goldman Cedarbaum
MIRIAM GOLDMAN
CEDARBAUM
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF
NEW YORK

----------X

In re:
CRYSEN/MONTENAY ENERGY COMPANY,

Debtor.

----------X

CRYSEN/MONTENAY ENERGY COMPANY,

Plaintiff,

-against-

SHELL OIL COMPANY and SCALLOP PETROLEUM COMPANY,

Defendants.

----------X

97 CIVIL
5072 (MGC)

JUDGMENT

(Filed
Aug. 31, 1999)

Plaintiff having appealed from a Order of the United States Bankruptcy Court for the Southern District of New York, (Blackshear, J.) and the said motion having come before the Honorable Miriam Goldman Cedarbaum, United States District Judge, and the Court thereafter on August 31, 1999, having rendered its Opinion (82790) affirming the Order of the Bankruptcy Court and dismissing the adversary proceeding with prejudice, it is,

ORDERED, ADJUDGED AND DECREED: That for the reasons stated in the Court's Opinion (82790) of August 31, 1999, the Order of the Bankruptcy Court is affirmed and the adversary proceeding is dismissed with prejudice.

DATED: New York, New York
August 31, 1999

JAMES M. PARKISON
Clerk of Court

BY: /s/ Illegible
Deputy Clerk

UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF – NEW YORK

In Re	**NOT FOR PUBLICATION**
CRYSEN/MONTENAY ENERGY COMPANY, Debtor.	Chapter 11 Case No. 86-B-11162(CB)
CRYSEN/MONTENAY ENERGY COMPANY, Plaintiff, - versus - SHELL OIL COMPANY AND SCALLOP PETROLEUM COMPANY, Defendants.	Adversary Proceeding No. 87-5178A

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Shell Oil Company ("Shell") and Scallop Petroleum Company ("Scallop"), collectively herein referred to as the "Defendants," seek by notice of motion: (i) confirmation of an arbitration award and (ii) summary judgment dismissing this adversary proceeding with prejudice, or alternatively, (iii) an order of proposed findings of fact and conclusions of law.

The plaintiff in this adversary proceeding, Crysen/Montenay Energy Company, (herein the "Debtor" or "Crysen"), by way of opposition to Defendants' motion,

cross-moves to (i) vacate the arbitration award and (ii) for partial summary judgment on Crysen's renewed motion of September 6, 1995.

The record in this adversary proceeding, which was presented to the arbitrators, is clear and fully documented; therefore, only a brief recitation of the facts is necessary.

BACKGROUND

On June 27, 1986, the Debtors filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code, ("Bankruptcy Code" or the "Code"). Crysen commenced the above adversary proceeding with a complaint dated March 16, 1987 against Scallop, a division of Scallop Corporation. At that time, Scallop Corp. was an independent legal entity and a wholly-owned subsidiary of Shell. Scallop's answer to the complaint, dated May 7, 1987, asserted a "First Affirmative Defense of Arbitration As To All Claims." On May 19, 1987, this Court denied Scallop's Motion to Compel Arbitration pursuant to its affirmative defense.

By agreement dated December 31, 1987, Shell caused Scallop Corp. to be dissolved and, *inter alia*, assumed all liabilities and rights as successor-in-interest. Upon discovery of the December 31, 1987 agreement between the Defendants, Crysen cross-moved to add Shell as a defendant and amended its complaint to restate its original three claims against Scallop and added a forth claim against Shell. Shell was joined as a party defendant pursuant to a stipulation so ordered on November 30, 1988,

whereby it agreed to submit to the jurisdiction of this Court for the sole purpose of this adversary proceeding.

On August 12, 1994, this Court executed an order finding that the above referenced adversary proceeding was a "non-core" proceeding. 28 U.S.C. § 157(b)(3).

On November 7, 1995, following various and lengthy discovery and related motion practice, including motions by both sides for partial summary judgment, on November 7, 1995, this Court heard a motion by Defendants to stay the adversary proceeding and compel arbitration ("Arbitration Motion"). On November 20, 1995, this Court entered an order granting the Arbitration Motion ("Arbitration Order") over Crysen's objections.

Consistent with the commercial arbitration rules of the American Arbitration Association, and pursuant to the Arbitration Order, Crysen, as plaintiffs in this action, submitted a Demand for Arbitration dated December 21, 1995. The Demand for Arbitration named as opposing parties, and was served upon, both Shell and Scallop and enumerated the same causes of action as the stayed adversary proceeding.

A panel of three arbitrators (the "Panel") received hundreds of exhibits into evidence, heard testimony of both fact and expert witnesses, received deposition testimony of still others, and heard legal arguments in a series of hearings over approximately a six month period. The panel also considered both pre-hearing and post-hearing memoranda of law submitted by plaintiff and Defendants.

On January 29, 1997, the panel issued a duly executed Award of Arbitrators ("the Award"). The Award denied Crysen's claims in their entirety. The Award has not been vacated or modified since issued.

Crysen's opposition and cross-motion to Defendant's herein motion alleges that: (1) the bankruptcy court lacks authority to compel or confirm arbitration awards regarding non-core proceedings; (2) Shell is not a proper party to the arbitration proceeding; and (3) the Award was improper because the panel demonstrated a "manifest disregard" for fundamentals of contract law and should thereby be vacated.

DISCUSSION

This Court has subject matter jurisdiction over the above captioned case pursuant to 28 U.S.C. §§ 1334(b) and 157(a) and the July 10, 1984 Standing Referral Order of this district. As a non-core proceeding, related to the underlying case, we present herein a proposed findings of fact and conclusions of law, pursuant to 28 U.S.C. § 157(c).

Must Compel Arbitration of Non-Core Proceedings.

Initially, Crysen argues that the bankruptcy courts do not have the authority over a noncore proceeding to compel compliance with an arbitration clause. In papers submitted, counsel for Debtor mischaracterizes Judge Learned Hand and misapplies the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.* ("FAA"). Crysen argues that article III courts alone may compel arbitration.

The federal policy favoring enforcement of agreements to arbitrate is firmly founded in U.S. Supreme Court case law. *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985). The federal statute implementing this policy is the FAA. In relevant part, the FAA states:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending . . . shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement. . . .

9 U.S.C. § 3. The FAA further provides that if parties fail to arbitrate, when such an agreement was properly preagreed, the appropriate court may compel parties to arbitration. 9 U.S.C. § 4.

The strong federal policy supporting enforcement of arbitration clauses may be overridden by a "countervailing policy manifested in another federal statute." *See Byrd*, 470 U.S. at 221. While such a countervailing policy has been repeatedly found in core bankruptcy proceedings, *see In Re Barney's, Inc., BNY Licensing Corp. v. Isetan of America Inc.*, 206 B.R. 336, 343 (Bankr. S.D.N.Y. 1997), non-core proceedings – as before the bench – are to be compelled to arbitration without discretion. *Hays & Co.*, 885 F. 2d at 1156-57.

This Court, under the jurisdictional provisions of 28 U.S.C. §§ 1334(b) and 157, may stay litigation and compel arbitration through the delegated authority of the district

court. Assuming denial of a motion to compel arbitration in the bankruptcy courts, either a full scale litigation of the non-core adversary proceeding would take place in district court, or the proceeding would be referred back to the bankruptcy court for a recommendation, followed, upon objection, by de novo review in the district court.[1] *See Hays and Co. v. Merrill Lynch*, 885 F. 2d 1149 (3rd Cir. 1989).

May Not Enter Final Judgments In Non-Core Proceedings.

While this Court's authority to compel arbitration in this matter is firmly supported, Crysen's argument that this Court may not confirm the Arbitration Award is more credible. As a non-core proceeding, and where parties do not otherwise consent, a bankruptcy court may not issue final orders or judgments. 28 U.S.C. § 157(c)(1). The judicial code and relevant case law clearly state that such a finding must be made by the district court upon a proposed findings of fact and conclusions of law.

Proper Party to Arbitration Process.

The next issue before the Court is whether Shell was a proper party to the arbitration process. Crysen contends that Shell was not a party to the original adversary proceeding, and that once Shell was joined in this matter and

---

[1] Although the May 17, 1987 motion to compel arbitration was denied by this Court, the issues within this matter had not yet been determined non-core.

entered its own amended answer, it did not include arbitration as an affirmative defense. A brief review of the facts however, demonstrates that Shell is a valid successor-in-interest to Scallop and the arbitration agreement.

Generally, only parties which personally submit to the original contract containing the arbitration clause are bound to arbitrate. *United Steelworkers of America v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960). It is clear from Crysen's own pleadings in this adversary proceeding that Crysen intended to be bound by the original contract between itself and Scallop. Arbitration clauses are further applicable to non-signatories who may be incorporated into the agent by ordinary principles of contract and agency law. *Thomson-CSF, S.A. v. American Arbitration Association*, 64 F. 3d 773, 776 (2d Cir. 1995) (citing *McAllister Bros., Inc. v. A&S Transportation Co.*, 621 F. 2d 519, 524 (2d Cir. 1980)). One such principle is assumption of obligation and liability. *Thomson-CSF*, 64 F. 3d at 776. Shell assumed all rights and liabilities of Scallop in the December 31, 1987 dissolution agreement. Notice of this agreement to Crysen has never been raised as an issue.

Waiver of Right to Arbitrate.

Crysen further argues that Defendants have waived their right to arbitrate due to untimeliness. Whether or not there has been a waiver is determined on a case-by-case basis, with a healthy regard for the policy of promoting arbitration. *Leadertex, Inc. v. Morganton Dyeing & Finishing Corp.*, 67 F. 3d 20, 25 (2d Cir. 1995) (citing *Kramer v.*

Hammond, 943 F. 2d 176, 179 (2d Cir. 1991)). In *Leadertex, supra*, the Second Circuit laid out several factors to consider: (1) amount of litigation completed; (2) amount of time elapsed from commencement of litigation to the request for arbitration; (3) proof of prejudice; and (4) proximity of a trial date. 67 F. 3d at 25. Applying these factors in turn, there had been minimal litigation in this matter as of the Arbitration Order on November 20, 1995. Parties had gone back and forth over discovery-related and procedural issues, with no substantive issues being decided by the Court. Although Crysen commenced this action back in 1987, not much time lapsed before Crysen was alerted to Defendants intent to compel arbitration. Debtor was put on notice regarding Defendants intent to compel arbitration both through the affirmative defense of the initial answer and by Defendants persistent motions to compel arbitration. Crysen has failed, both at the time of the November 1995 Arbitration Motion and for this present motion, to demonstrate sufficient prejudice. Receiving an unfavorable ruling is not sufficient.

Vacating Arbitration Award.

Lastly, despite allegations that this Court has no authority to compel or confirm the Arbitration Award, Crysen argues that this Court should vacate the Award because the panel manifestly disregarded elementary contract law, and that Crysen was denied the opportunity to fully cross-examine Defendants' chief expert witness. The burden before Crysen to vacate an arbitration award is a significantly high one. The "manifest disregard" standard requires more than mere error in understanding or applying the law. *Willemijn Houdstermaatschappij, BV v.*

Standard Microsystems Corp., 103 F. 3d 9, 12 (2d Cir. 1997) (citing *Siegel v. Titan Industry Corp.*, 779 F. 2d 891, 892 (2d Cir. 1985)). In fact, the movant has the considerably greater burden of demonstrating that the arbitrators understood and correctly stated the law. but proceeded to ignore it. *Standard Microsystems Corp.*, 103 F. 3d, at 12 (citations omitted). It is extremely difficult to apply this standard when, as is the case at bar, arbitrators have provided no explanation for their decision. Therefore, this Court must review the conduct and conclusions of the arbitrators as available.

The underlying principles of law to this adversary proceeding are that of basic contracts, the Uniform Commercial Code, and customs and practices within the industry. The parties to this action are both merchants within the same industry. The focal issues raised in Crysen's opposition Motion and Cross-Motion include: reasonableness of delivery; good-faith shipment; admissibility of expert testimony; and appropriateness of inspection of goods. At no point in Crysen's forty-five page submission does Debtor meet its burden as set-out above to vacate the Award. Arbitration Awards are subject to only limited review in large part to avoid undermining the dual goal of (1) settling disputes efficiently and (2) avoiding long and expensive litigation. *Folkways Music Publishers v. Weiss*, 989 F. 2d 108, 111 (2d Cir. 1993). The Panel heard extensive testimony, viewed exhibits and analyzed both post and pre-hearing memoranda. There is nothing before this Court warranting vacating the Arbitration Award.

For the foregoing reasons, the motion to dismiss the adversary proceeding with prejudice is hereby granted,

and the cross-motion to vacate the Arbitration Award is denied. Having found this proceeding to be a non-core matter, this Court's memorandum shall constitute findings of fact and conclusions of law pursuant to 28 U.S.C. § 157(c).

Dated: May 19, 1997
New York, New York

/s/ Cornelius Blackshear
THE HONORABLE
CORNELIUS BLACKSHEAR
UNITED STATES
BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	
CRYSEN/MONTENAY ENERGY COMPANY, Debtor.	Joint Administration Case No. 86-B-11162 (CB)
CRYSEN/MONTENAY ENERGY COMPANY, Plaintiff, v. SHELL OIL COMPANY and SCALLOP PETROLEUM COMPANY, Defendants.	Adversary Proceeding No. 87-518A

ORDER GRANTING DEFENDANTS' MOTION TO STAY THIS ADVERSARY PROCEEDING AND TO COMPEL ARBITRATION

A motion seeking an order granting a stay of the above adversary proceeding and to compel its arbitration having come on to be heard by this Court on November 7, 1995; and the Court having heard Anderson Kill Olick & Osninsky, P.C., co-counsel to the Defendants, Shell Oil Company and Scallop Petroleum Company, by Roy Babitt, Esq. and Becker, Glynn, Melamed & Muffly, counsel to the Plaintiff, Crysen/Montenay Energy Company, by Joseph D. Becker Esq. and the Court having read the motion and its supporting papers, the reply papers and

the opposition papers with respect thereto, the Court having considered the arguments of counsel for the Defendants and the Plaintiff, and the Court having ruled in open court upon the record on November 7, 1995 that the motion for a stay of the above adversary proceeding and to compel its arbitration should be granted.

Now, it is

ORDERED, that Defendants' motion for a stay of the above adversary proceeding and to compel its arbitration is granted in all respects; and it is further

ORDERED, that the above adversary proceeding is hereby stayed pending its arbitration; and it is further

ORDERED, that Plaintiff Crysen/Montenay Energy Company is compelled to arbitrate this adversary proceeding in New York City by three arbitrators in accordance with the rules of the American Arbitration Association and shall file a demand for this arbitration within ten days of the entry of this order, and it is further

ORDERED that the automatic stay of 11 U.S.C. §362 is hereby modified and vacated to the extent necessary to permit arbitration of the adversary proceeding in New York City by three arbitrators in accordance with the rules of the American Arbitration Association.

Dated: New York, New York
November 20, 1995

/S/ Cornelius Blackshear
UNITED STATES BANKRUPTCY
JUDGE

AMERICAN ARBITRATION ASSOCIATION
Arbitration Tribunal

In the Matter of the Arbitration between

Re: 13 152 00978 95
CRYSEN/MONTENAY ENERGY COMPANY
and
SHELL OIL COMPANY AND SCALLOP
PETROLEUM COMPANY

AWARD OF ARBITRATORS

WE, THE UNDERSIGNED ARBITRATORS, having been designated pursuant to an Order of the United States Bankruptcy Court for the Southern District of New York entered November 23, 1995, and having been duly sworn, and having duly heard the proofs and allegations of the Parties, do hereby, AWARD, as follows:

1. With respect to the claims of CRYSEN/MONTENAY ENERGY COMPANY, hereinafter referred to as CLAIMANT, against SHELL OIL COMPANY AND SCALLOP PETROLEUM COMPANY, hereinafter referred to as RESPONDENTS, same are hereby denied in their entirety.

2. The Parties shall bear their own attorneys' fees and expenses.

3. The compensation of the Arbitrators totalling TWENTY FOUR THOUSAND DOLLARS ($24,000.00), shall be borne equally by the Parties.

4. The administrative fees and expenses of the American Arbitration Association totalling SEVEN

THOUSAND EIGHT HUNDRED SEVENTY THREE DOLLARS AND THIRTY SEVEN CENTS ($7,873.37), shall be borne equally by the Parties. Therefore, RESPONDENTS shall pay to CLAIMANT the sum of TWO THOUSAND FOUR HUNDRED EIGHTY DOLLARS ($2,480.00), representing that portion of said fees and expenses previously advanced by CLAIMANT to the Association over and above its one-half share, and RESPONDENTS shall pay to the American Arbitration Association the sum of FORTY DOLLARS ($40.00), representing the balance of said fees and expenses still due the Association.

5. This Award is in full settlement of all claims submitted to this Arbitration.

/s/ William L.D. Barrett, Esq. 1/24/97
William L.D. Barrett, Esq./DATED

/s/ Randle B. Carpenter Jr., Esq. 1/29/97
Randle B. Carpenter Jr., Esq./ DATED

/s/ George R. Freund 1/27/97
George R. Freund/DATED

STATE OF NEW YORK)
)ss.:
COUNTY OF NEW YORK)

I, William L.D. Barrett, Esq., do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument which is my Award.

1/24/97 /s/ William L.D. Barrett
(DATED) (SIGNATURE)

STATE OF NEW YORK)
)ss.:
COUNTY OF NEW YORK)

I, Randle B. Carpenter Jr., Esq., do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument which is my Award.

1/29/97 /s/ Randle B. Carpenter Jr.
(DATED) (SIGNATURE)

STATE OF NEW YORK)
)ss.:
COUNTY OF NEW YORK)

I, George R. Freund, do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument which is my Award.

1/27/97 /s/ George R. Freund
(DATED) (SIGNATURE)

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
40 Foley Square
New York, NY 10007

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 1st day of November Two Thousand

---

In re: Crysen/Montenay Energy Co.

Debtor.

Crysen/Montenay Energy Co.,

Appellant,

v.

Shell Oil Co. & Scallop Petroleum Co.,

Defendants.

99-5067

(Filed Nov. 1, 2000)

A petition for rehearing and a petition for rehearing in banc having been filed herein by the Appellant Crysen/Montenay Energy Co,

> Upon consideration by the panel that decided the appeal, it is Ordered that the petition for rehearing is **DENIED**.

It is further noted that the petition for rehearing in banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the

appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT
Roseann B. McKechnie, Clerk

By: /s/ Beth J. Meador
Beth J. Meador,
Administrative Attorney

STATUTORY APPENDIX

Article III, Section 1, of the United States Constitution provides:

> The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services a Compensation, which shall not be diminished during their Continuance in Office.

Title 9, Section 3, of the United States Code provides in pertinent part:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending . . . shall on application of one of the parties stay the trial of the action until such arbitration has been had. . . .

Title 9, Section 4, of the United States Code provides in pertinent part:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement . . . Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure . . . If no jury

> trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. . . .

Title 28, Section 157(c)(1), of the United States Code provides:

> A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

Title 28, Section 451, of the United States Code provides in pertinent part:

> As used in this title:
>
> The term "court of the United States" includes the Supreme Court of the United States, courts of appeals, district courts constituted by chapter 5 of this title, including the Court of International Trade and any court created by Act of Congress the judges of which are entitled to hold office during good behavior.
>
> The terms "district court" and "district court of the United States" mean the courts constituted by chapter 5 of this title.

Supreme Court, U.S.
FILED
FEB 14 2001
OFFICE OF THE CLERK

No. 00-1119

IN THE

Supreme Court of the United States

CRYSEN/MONTENAY ENERGY COMPANY,
Petitioner,

v.

SHELL OIL COMPANY and
SCALLOP PETROLEUM COMPANY,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Of Counsel
JAMES L. MICHALAK
4822 One Shell Plaza
P.O. Box 2463
Houston, Texas 77252
(713) 241-3587

LAWRENCE KILL
Counsel of Record
MARK L. WEYMAN
KIRSTEN M. ERIKSSON
ANDERSON KILL & OLICK, P.C.
1251 Avenue of the Americas
New York, New York 10020
(212) 278-1000
Counsel for Respondents

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

19pp

QUESTIONS PRESENTED

1. Whether the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, removes from bankruptcy courts the power to stay non-core adversary proceedings and compel arbitration, when any such order will be reviewed *de novo* by the district court before a final order or judgment may be entered.

2. Whether: (i) the rules for conducting an arbitration proceeding; (ii) the procedures for rendering an arbitration award; and (iii) the standard of review of an arbitration award, are different when a bankruptcy court, rather than a district court, is the first court to review the award.

STATEMENT PURSUANT TO RULE 29.6

Shell Oil Company ("Shell") is wholly owned by Shell Petroleum Inc., a Delaware corporation, whose shares are directly or indirectly owned 60 percent by Royal Dutch Petroleum Company, The Hague, The Netherlands, and 40 percent by the Shell Transport and Trading Company, both of which are publicly-owned holding companies. Scallop Petroleum Company ("Scallop") was a division of Scallop Corporation which was a wholly owned subsidiary of Shell Oil Company at the time Scallop Corporation was dissolved in 1987.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
STATEMENT PURSUANT TO RULE 29.6	ii
TABLE OF AUTHORITIES	iv
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	1
COUNTERSTATEMENT OF THE CASE	1
REASONS FOR DENYING THE PETITION	3
I. BANKRUPTCY COURTS HAVE THE POWER TO STAY NON-CORE PROCEEDINGS AND COMPEL ARBITRATION	4
A. Bankruptcy Courts Have The Power To Stay Non-Core Actions And Compel Arbitration By Virtue Of Their Inherent Power And The Power Referred By The District Courts	5
B. Bankruptcy Courts Are "Courts of the United States" As Used In The FAA	7
II. THE ARBITRATORS' AWARD WAS PROPERLY RENDERED AND REVIEWED	9
CONCLUSION	11

TABLE OF AUTHORITIES

CASES — Page

Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265 (1995) 10
Celotex Corp. v. Edwards, 514 U.S. 300 (1995) ... 6
Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213 (1985) 8
Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681 (1996) 4
First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995) 9
Gavlik Construction Co. v. H.F. Campbell Co., 526 F.2d 777 (3d Cir. 1975), *overruled on other grounds, Zosky v. Boyer*, 856 F.2d 554 (3d Cir. 1988) 5
Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, 885 F.2d 1149 (3d Cir. 1989) 6
Landis v. North American Co., 299 U.S. 248 (1936) 5
National Association of Broadcast Employees & Technicians v. American Broadcasting Co., Inc., 140 F.3d 459 (2d Cir. 1998), *cert. denied*, 525 U.S. 1069 (1999) 7
Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982) 7, 8, 9
Prima Paint Corp. v. Flood & Conklin Manufacturing Co., 388 U.S. 395 (1967) 10
Southland Corp. v. Keating, 465 U.S. 1 (1984) 4
Sutton v. United Air Lines, 527 U.S. 471 (1999) ... 8
Vermont Agency of Natural Resources v. United States ex rel. Stevens, 120 S. Ct. 1858 (2000) ... 8

STATUTES

9 U.S.C. § 3 ..... 4, 5, 7
9 U.S.C. § 4 5
9 U.S.C. § 9 9

TABLE OF AUTHORITIES—CONTINUED

	Page
9 U.S.C. § 10	9, 10, 11
11 U.S.C. § 105(a)	4, 5, 6
28 U.S.C. § 151	5, 6
28 U.S.C. § 157	*passim*
28 U.S.C. § 451	7, 8
28 U.S.C. § 1334(b)	6
MISCELLANEOUS	
Black's Law Dictionary	10
Norton Bankruptcy Law and Practice	4

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

In addition to the constitutional and statutory provisions quoted in the Appendix ("Pet. App.") to the Petition for a Writ of Certiorari (the "Petition"), pertinent provisions of 28 U.S.C. § 157(a) and 11 U.S.C. § 105(a) are reproduced in the Appendix to this Brief in Opposition to the Petition.

COUNTERSTATEMENT OF THE CASE

In January 1986, petitioner Crysen/Montenay Energy Company ("Crysen") contracted with Scallop for the sale of 300,000 barrels of fuel oil. The contract provided for any disputes arising thereunder to be submitted to arbitration before the American Arbitration Association. When the oil was delivered, it did not conform to the specifications of the contract and, therefore, disputes arose.

In June 1986, Crysen filed a petition for relief under Chapter 11 of Title 11 of the United States Code. In March 1987, Crysen commenced an adversary proceeding against Scallop. Scallop immediately asserted an affirmative defense based upon the agreement to arbitrate and promptly moved to compel arbitration, which motion was initially denied on May 29, 1987. As a result, the parties proceeded with the pending litigation. Shell was added to the litigation after it assumed Scallop's liabilities upon Scallop's dissolution.[1]

Subsequently, due to a change in the law, it became clear that the standards the bankruptcy court had applied in denying the initial motion to compel arbitration were incorrect, and Shell renewed the motion before the bankruptcy court to stay the adversary proceeding and compel arbitration.[2] Shell's motion was granted by order entered on

---

[1] For ease of reference Shell and Scallop will collectively be referred to herein as "Shell."

[2] By that time, the bankruptcy court had held that the adversary proceeding constituted a "non-core" proceeding.

November 20, 1995. The parties proceeded to arbitration, which consisted of a pre-hearing conference, pre- and post-hearing briefs, five days of witness testimony and a half day of closing arguments and questions to counsel by the panel of arbitrators. In addition, deposition testimony was designated and cross-designated by the parties and numerous documents were admitted into evidence. In short, a full and fair hearing was conducted by the arbitrators.

The three-member panel of arbitrators (the "Panel") issued an Award of Arbitrators (the "Award") unanimously denying Crysen's claims in their entirety. Shell moved before the bankruptcy court to confirm the Award and for summary judgment dismissing the adversary proceeding. Crysen cross-moved to vacate the Award. In support of the motion and cross-motion, the parties submitted portions of the transcript of the arbitration hearing, as well as certain of the exhibits which had been relied upon, and made the entire transcript of the arbitration proceeding available to the bankruptcy court. After reviewing the evidence presented to the arbitrators by both Shell and Crysen, the bankruptcy judge issued proposed findings of fact and conclusions of law (the "Proposed Findings") recommending that the Award be confirmed and that the adversary proceeding be dismissed. Pet. App. A51.

Crysen filed Objections to the Proposed Findings, arguing that: (i) the Bankruptcy Court lacked the power to issue an order compelling arbitration; (ii) Shell waived its right to arbitration; (iii) the Panel's Award was in "manifest disregard of the law"; and (iv) the Panel committed misconduct by refusing to hear evidence pertinent and material to the controversy.[3] The district court conducted a *de novo* review of the matters raised by the Objections. Based on the

[3] Crysen has not included in the Petition its claims that Shell waived its right to seek arbitration, that the Panel acted in manifest disregard of the law, or that the Panel committed misconduct.

evidence presented by the parties, the district court rejected each of Crysen's Objections in turn.

Crysen then appealed to the United States Court of Appeals for the Second Circuit, arguing that: (i) Shell waived its right to arbitrate; (ii) the bankruptcy court lacked the power to order arbitration; and (iii) the district court's *de novo* review of the bankruptcy court's decision was unconstitutional. The Second Circuit rejected Crysen's arguments and affirmed the decision of the district court in its entirety.

REASONS FOR DENYING THE PETITION

The Petition should be denied because it does not raise any compelling issues for resolution by this Court. The Second Circuit's decision that a bankruptcy court has the authority to stay a non-core proceeding and compel arbitration does not conflict with the decision of any other United States Court of Appeals. Similarly, the Second Circuit's decision does not depart from "the accepted and usual course of judicial proceedings,"[4] as bankruptcy courts routinely stay proceedings in favor of arbitration, and Crysen has not cited a single court decision to the contrary. Moreover, the question of whether a bankruptcy court has the authority to stay actions and compel arbitration does not raise any unresolved issue of federal law that must be resolved by this Court. Although Crysen argues that no court has "intelligibly" resolved the question, Pet. at 5, the Second Circuit's decision is well reasoned and completely consistent with federal law.

The second question raised by Crysen is similarly unworthy of review. Crysen argues that 28 U.S.C. § 157 and Article III of the Constitution require that the standard of review imposed upon a bankruptcy court examining an arbitrator's award should be greater than that for a district court. In addition, Crysen contends that the bankruptcy court must impose new and different rules upon the arbitrators in

---

[4] Sup. Ct. R. 10(a).

conducting the hearing and rendering the award. Crysen's effort to create a strawman, and then knock it down, fails. Thus, the law is clear that, in a non-core case in which it is to issue proposed findings of fact and conclusions of law, a bankruptcy court must review an arbitrator's award under the same standard as would the district court—that is, under the standards set forth by the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* ("FAA"), and by relevant caselaw. Again, there is no conflict among the Courts of Appeals on this point, the decision below does not depart from the accepted and usual course of judicial proceedings, nor does this case raise an unresolved issue of federal law. For these reasons, the Petition should be denied.

I. BANKRUPTCY COURTS HAVE THE POWER TO STAY NON-CORE PROCEEDINGS AND COMPEL ARBITRATION

Bankruptcy courts routinely stay proceedings in favor of arbitration in both core and non-core proceedings.[5] Their ability to do so need not be grounded in § 3 of the FAA, as Crysen would have the Court believe, but rather in the grant of power under 28 U.S.C. §157 and 11 U.S.C. § 105(a). Indeed, the FAA could not be a *source* of the bankruptcy court's power, as FAA § 3 does not contain a *grant* of power at all, but rather *withdraws* power from the courts by revoking their discretion to hear disputes which the parties previously agreed to arbitrate. *See Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 684 (1996); *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984). Moreover, like all courts, bankruptcy courts have the power to stay actions before them

---

[5] The district court cited numerous cases in which bankruptcy courts had ordered arbitration. Pet. App. A29. Likewise, a leading commentator has observed that "[t]he bankruptcy courts have the power to compel arbitration under a valid arbitration clause unless it can be demonstrated that enforcement of the arbitration clause would be contrary to the provisions or purpose of the Bankruptcy Code." W. Norton, 1 *Norton Bankruptcy Law and Practice* (2d ed. 1995) § 4:47A (Supp. 1997).

as part of their inherent power to control matters on their dockets. *See Landis v. North American Co.*, 299 U.S. 248, 254 (1936). The Second Circuit was therefore correct to hold that a bankruptcy court not only has the power to stay a non-core proceeding and compel arbitration, but that it generally does not have discretion to do otherwise. Because the Second Circuit correctly decided this issue in conformity with federal law and practice, the Petition should be denied.

A. Bankruptcy Courts Have The Power To Stay Non-Core Actions And Compel Arbitration By Virtue Of Their Inherent Power And The Power Referred By The District Courts

There is no dispute that a district court has the power to stay an action, as such power is within the court's inherent power "to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants." *Landis*, 299 U.S. at 254. Moreover, district courts have the inherent power to compel parties to arbitrate disputes. *See, e.g., Gavlik Constr. Co. v. H.F. Campbell Co.*, 526 F.2d 777 (3d Cir. 1975), *overruled on other grounds, Zosky v. Boyer*, 856 F.2d 554 (3d Cir. 1988). Crysen has cited no authority to demonstrate that bankruptcy courts do not have the same inherent power. Moreover, bankruptcy courts have specifically been granted such power by virtue of the district courts' referral of power under 28 U.S.C. § 157(a), by their status as "units" of the district courts pursuant to 28 U.S.C. § 151, and by the broad grant of authority from Congress in § 105(a) of the Bankruptcy Code.[6]

---

[6] Crysen argues, in a footnote, that the bankruptcy court's inherent power cannot apply to stays in connection with arbitration, because doing so would render FAA §§ 3 and 4 "superfluous." Pet. App. 7, n.4. A court's power to stay proceedings is discretionary, however, while the FAA makes such stays mandatory. Thus, the FAA is not superfluous, but rather imposes an important restriction on a court's discretion to issue a stay.

The district courts are granted original jurisdiction of all civil proceedings arising under Title 11 and of proceedings arising in or related to cases under Title 11. 28 U.S.C. § 1334(b). Pursuant to 28 U.S.C. § 157(a), the district court may refer these proceedings to the bankruptcy court, which is a "unit" of the district court. 28 U.S.C. § 151.

Both the power to stay actions and the power to compel arbitration are included within the authority delegated to bankruptcy courts pursuant to 28 U.S.C. § 157(a). Moreover, pursuant to 11 U.S.C. § 105(a), bankruptcy courts are granted broad equitable powers to issue "any order, process or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." As this Court has held, "Congress intended to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate." *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995). No authority exists to indicate that Congress intended bankruptcy courts to be deprived of the power to compel arbitration, and enforcing private agreements to arbitrate is in no way inconsistent with the purposes of the Bankruptcy Code, especially in a non-core case. *See Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith*, 885 F.2d 1149, 1157-61 (3d Cir. 1989).

Locating such power in the bankruptcy courts does not run afoul of either 28 U.S.C. § 157(c) or Article III, as Crysen contends. In order to address the constitutional concerns of having a non-Article III court determine matters of state law, § 157(c) mandates that, in non-core cases, a bankruptcy court cannot enter a final order or judgment in such cases, but rather must make proposed findings of fact and conclusions of law to the district court, which must undertake a *de novo* review of all matters to which objections are raised before entering the final order or judgment. An order staying an action and compelling arbitration is not a final order or judgment, and, therefore, is within the authority granted to

bankruptcy courts. A district court's *de novo* review will encompass the bankruptcy court's decision to compel arbitration, as it did in this case. Thus, as the district court held in this case, because the final power to determine whether a dispute should have been arbitrated and whether the arbitration award should be confirmed rests with the district court, "the bankruptcy judge's enforcement of an arbitration clause under these circumstances does not even indirectly run afoul of 28 U.S.C. § 157(c)(1) . . . [or] offend the teaching of *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982)." Pet. App. A29.

Indeed, it should be noted that questions concerning the arbitrability of a dispute do not need to be determined before the arbitration occurs—it is enough that a court with the power to determine arbitrability has the opportunity to do so before the award is confirmed. *See National Ass'n of Broadcast Employees & Technicians v. American Broadcasting Co., Inc.*, 140 F.3d 459, 462 (2d Cir. 1998), *cert. denied*, 525 U.S. 1069 (1999). Accordingly, even if the bankruptcy court in this case was not empowered to compel arbitration, the district court's subsequent ruling that the case was properly sent to arbitration moots any argument that the bankruptcy court lacked the power to do so.

Thus, for this reason alone, the bankruptcy court's decision to stay the action and compel arbitration was proper, and the Petition should be denied.

B. Bankruptcy Courts Are "Courts of the United States" As Used In The FAA

Even if the bankruptcy court's power to order arbitration depends in some way on the FAA, interpreting FAA § 3 to apply to bankruptcy courts as well as district courts is the only reasonable reading of the statute.[7]

---

[7] Crysen's argument, that the definition of "courts of the United States" in FAA § 3 is governed by the definition of that phrase contained in 28

This Court has held that, " 'in all cases of statutory construction, our task is to interpret the words [of the statute] in light of the purposes Congress sought to serve.' " *Sutton v. United Air Lines*, 527 U.S. 471, 496 (1999) (citing *Chapman v. Houston Welfare Rights Org.*, 441 U.S. 600, 608 (1979)). Congress enacted the FAA to ensure that arbitration agreements were enforced by the courts, in effect overruling prior court practice of hearing contract cases despite the existence of a valid arbitration clause. *See Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-20 (1985) (citing H.R. Rep. No. 96, 68th Cong., 1st Sess., 1-2 (1924)). By making arbitration mandatory, the FAA effectively withdraws a court's power to hear such cases. Congress could not have intended district courts to be bound by the FAA's mandate to compel arbitration, while leaving bankruptcy courts free to act otherwise. Indeed, as bankruptcy courts derive their power from the district courts and cannot constitutionally exercise greater power than the district courts, *see Northern Pipeline*, 458 U.S. 50, it would be an unconstitutional interpretation of the FAA to permit bankruptcy courts the power to hear cases which district courts cannot. Thus, the FAA should not be interpreted to reach such a result. *See Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 120 S. Ct. 1858, 1870 (2000). As the Petition advocates the adoption of such an interpretation of the FAA, the Petition should be denied for this reason as well.

U.S.C. § 451, is incorrect and not supported by any authority. Pet. at 6-8. Section 451, by its terms, only applies to the use of that phrase in Title 28, not in Title 9, where the FAA is contained. The cases cited by Crysen are similarly inapplicable, as those cases also rely on the language of § 451 to hold that bankruptcy courts are not "courts of the United States" in cases not involving the FAA.

II. THE ARBITRATORS' AWARD WAS PROPERLY RENDERED AND REVIEWED

Although Crysen's reasoning is less than clear, it appears to be asking this Court to re-write the rules that govern the administration of arbitration proceedings and the review of arbitration awards when those awards are to be reviewed in the first instance by a bankruptcy court rather than by a district court. In effect, Crysen argues that the bankruptcy court in this case should have ordered the arbitration to take place under rules other than those to which the parties agreed, and that the bankruptcy court should have reviewed the Award *de novo*, rather than under the standards set forth in FAA §§ 9 and 10 and the controlling caselaw.[8] Crysen's argument is contrary to established federal law. Accordingly, the Petition should be denied.

An arbitrator's award may be vacated only if the award was procured by fraud, the arbitrators were partial or corrupted, the arbitrators were guilty of misconduct, the arbitrators exceeded their powers, or the arbitrators otherwise acted in "manifest disregard of the law." *See* FAA § 10; *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 939 (1995). Contrary to Crysen's contention, nothing in 28 U.S.C. § 157(c) or Article III requires a court to undertake a *de novo* review of an award just because the first court to review the award is a bankruptcy court rather than a district court.

Section 157(c) was enacted in response to the constitutional limitations placed on the power of the bankruptcy courts in non-core cases by *Northern Pipeline*. It thus requires that the district court undertake a *de novo* review of a bankruptcy court's proposed findings of fact and

---

[8] Although it does not say so directly, Crysen can mean nothing else when it argues that the bankruptcy court "was in error to conduct the confirmation proceeding like a district court under FAA §§ 9 and 10." Pet. at 12.

conclusions of law before a final order can be issued. The district court will then confirm the award so long as the arbitrators did not act in the manner set forth in FAA § 10 or in manifest disregard of the law. The purpose of this *de novo* review is to permit the parties to have a district court hear their case as if it had not been referred to bankruptcy court.[9] Thus, there is no basis upon which to find that the bankruptcy court must use a standard other than that used by the district court.

The standard of review required of district courts also conforms to the purposes of the FAA to enforce arbitration agreements and to obtain a rapid resolution with a minimum of judicial interference.[10] In accordance with these purposes, arbitrators are generally not required to keep transcripts of proceedings or set forth the reasons for their decision in writing. In this case, for example, the parties had agreed to arbitrate pursuant to the rules of the American Arbitration Association, which do not require the arbitrators to either create a record or set forth the reasons for their award.[11] While Crysen contends that the bankruptcy court must instruct the arbitrators to keep such a record in order to comply with its responsibilities under § 157(c), it offers no authority or justification for its position.

---

[9] Indeed, the very purpose of a *de novo* hearing is to "try[] [the] matter anew the same as if it had not been heard before and as if no decision had been previously rendered." *Black's Law Dictionary* 721 (6th ed. 1990).

[10] *See Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 280 (1995) (citing House of Representatives Report stating that arbitration is, among other things, cheaper and faster than litigation); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967) ("unmistakably clear congressional purpose" of FAA is that arbitration "be speedy and not subject to delay and obstruction in the courts").

[11] In this case, however, the parties did have a transcript of the arbitration proceeding, relevant portions of which are part of the record below.

In this case, both the bankruptcy court and the district court, respectively, properly reviewed the Award. They each did so after reviewing the record and the extensive evidence cited to by both parties. Thus, the district court properly adopted the bankruptcy court's Proposed Findings after a *de novo* review consistent with the dictates of FAA § 10 and controlling caselaw.

Simply put, no reason exists to subject arbitration awards rendered on referral from a bankruptcy court to a different procedure and standard of review than arbitration awards rendered after referral from a district court, and Crysen has cited no authority to support such a radical change in the law. Such a result is grounded neither in the requirements of § 157 nor the Constitution, is contrary to the very purposes of arbitration, and should be rejected.

CONCLUSION

For the reasons set forth above, the Petition should be denied.

Respectfully submitted,

Of Counsel

JAMES L. MICHALAK
4822 One Shell Plaza
P.O. Box 2463
Houston, Texas 77252
(713) 241-3587

LAWRENCE KILL
Counsel of Record
MARK L. WEYMAN
KIRSTEN M. ERIKSSON
ANDERSON KILL & OLICK, P.C.
1251 Avenue of the Americas
New York, New York 10020
(212) 278-1000

Counsel for Respondents

February 12, 2001

STATUTORY APPENDIX

STATUTORY APPENDIX

Title 28, Section 157(a) of the United States Code provides in pertinent part:

> (a) Each district court may provide that any or all cases under title 11 and any or all proceedings arising under title 11 or arising in or related to a case under title 11 shall be referred to the bankruptcy judges for the district.

Title 11, Section 105 of the United States Code provides in pertinent part:

> (a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.